CONSULTATION PAPER

Deal Protection Devices

18 September 2023

TAKEOVERS PANEL
TE PAE WHITIMANA

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Contents

Glossary

In this paper, unless the context otherwise requires, the following terms have the meaning set out below:

Australian Panel	the Australian Takeovers Panel
Code	the Takeovers Code as set out in the schedule to the Takeovers Regulations 2000
Code company	has the meaning set out in section 2A of the Takeovers Act and rule 3A of the Code
Code offer	an offer as defined in the Code, being an offer to which the Code applies for voting securities and any other financial products to which the offer is required to extend under the Code
Companies Act	the Companies Act 1993
Deal protection device	an obligation that, in a scheme or Code offer, in some way restricts the target's ability to engage with competing offerors and/or imposes consequences on a party for not complying with that obligation or otherwise not proceeding with the transaction
No-objection Statement	a statement from the Panel indicating that the Panel has no objection to a scheme under section 236A(2)(b)(ii) of the Companies Act
offeror	an offeror or a potential offeror
OIA	the Official Information Act 1982
Panel	the New Zealand Takeovers Panel
paper	this consultation paper
Privacy Act	the Privacy Act 2020
scheme	a scheme of arrangement under Part 15 of the Companies Act 1993
SIA	a scheme implementation agreement or other analogous agreement under which parties agree the terms of a scheme and how it will be implemented
Singapore Code	the Singapore Code on Take-overs and Mergers
Takeovers Act	the Takeovers Act 1993

Introduction

The New Zealand takeovers regime and recent developments in market practice

1 In New Zealand, takeover offers are regulated by the 'rules based' system set out in the Code.[1] Given this rules-based regime, it is appropriate, from time to time, to review the rules of the Code to assess how they are operating. This is important to ensure that the Code responds to market developments.

2 As to developments in the New Zealand takeovers market:

(a) The current regime for regulation of changes of control of Code companies has been in place since 2014, when amendments to the Takeovers Act and Companies Act brought in the current regulatory provisions relating to schemes.[2]

(b) Since 2014, the Panel has observed changes in the manner in which public M&A transactions are conducted, including:

(i) a reduction in the use of Code-regulated transactions over time, with a majority of transactions progressing by way of a scheme; and

(ii) SIAs becoming increasingly sophisticated, and in New Zealand, but particularly in Australia, deal protection devices (such as exclusivity provisions) becoming increasingly common.

3 The Panel is of the view that the takeovers market in New Zealand functions well. In particular, the Panel considers schemes to be a legitimate structure to effect changes of control of Code companies.

4 However, the Panel has been considering whether certain changes to the New Zealand takeovers regime might be appropriate.

5 The Panel has prepared this paper (and another related paper) to seek the views of market participants so that the Panel can take these views into account when deciding what (if any) next steps it should take, including whether to make any recommendations for law reform.

Scope of this consultation

6 This paper relates to deal protection devices in relation to Code transactions and schemes. In particular, it considers whether deal protection devices should be restricted and, if so, what might be restricted. The Panel expects that the key steps following publication of this paper would be as follows:

(a) The Panel receives and considers submissions. The Panel may then make law reform recommendations to the Minister of Commerce and Consumer Affairs.

(b) Assuming the Panel makes law reform recommendations, the process would likely proceed as follows:

(i) MBIE and potentially other Government agencies would analyse the law reform recommendations (this consultation is being undertaken at the initiative of the Takeovers Panel and is not, at present, part of a Government work programme).

[1] This contrasts with jurisdictions such as Australia, where the Australian Panel has a relatively broad and flexible jurisdiction to determine whether there have been 'unacceptable circumstances' in respect of takeover transactions.

[2] While schemes were well established as a transaction structure well before 2014, the current regulatory framework for Code companies, with the Panel's formal engagement in the process, was new.

(ii) The Minister / Cabinet would decide whether to progress any law reforms.

(iii) Parliamentary Counsel Office would prepare the relevant amending legislation and regulations.

(iv) Amendments to legislation/regulations would be enacted/made in the usual manner.

7 The other related consultation paper, entitled "Regulatory Alignment of Schemes and Code Offers – Application of Certain Code Rules to Schemes", considers whether certain Code rules should be applied directly to schemes and how Panel enforcement powers might work if reform is appropriate (it is available here).

Contents of this paper

8 This paper comprises:

(a) The Panel's background considerations relating to this topic (paragraphs 20 – 29).

(b) Discussion of the policy problem arising in relation to deal protection devices (paragraphs 31 – 57).

(c) The Panel's preliminary view as to potential reform in this area (paragraphs 58 – 71).

9 Although the Panel has formed preliminary views on potential reform, the Panel is seeking information and feedback to further inform its view.

10 A table setting out all questions asked within the consultation can be found at **Schedule 1** to this paper.

Policy objectives

11 The Panel's objectives in considering the proposed amendments mirror the statutory objectives for the Code, as set out in section 20 of the Takeovers Act, namely:

(a) encouraging the efficient allocation of resources;

(b) encouraging competition for the control of Code companies;

(c) assisting in ensuring that the holders of financial products in a takeover are treated fairly;

(d) promoting the international competitiveness of New Zealand's capital markets;

(e) recognising that the holders of financial products must ultimately decide for themselves the merits of a takeover offer; and

(f) maintaining a proper relation between the costs of compliance with the Code and the benefits resulting from it.

Request for comments on this paper

12 The Panel invites submissions on the matters raised in this paper.

13 The closing date for submissions on this paper is **Friday, 1 December** 2023.

14 Submissions should be sent by email to the Panel for the attention of:

Rebecca Budd
Law Clerk
rebecca.budd@takeovers.govt.nz

Mark Cunliffe
General Counsel
mark.cunliffe@takeovers.govt.nz

Discussions regarding the proposals

15 If you have any questions in relation to the matters raised in this paper that you would like to discuss prior to making a submission, please feel free to contact the Panel executive at the details above.

The Official Information Act and the Privacy Act

16 Any submissions received by the Panel are subject to the OIA. The Panel may make submissions available upon request under that Act.

17 If any submitter wishes any information in a submission to be withheld, the submission should contain an appropriate request (together with a clear identification of the relevant information to be withheld and the reasons for the request). Where a request is made for disclosure of submissions that the submitter has asked to be withheld, such a request will be considered in accordance with the OIA.

18 The Privacy Act establishes certain principles which apply to the collection, use and disclosure of information about individuals by various agencies, including the Panel. Any personal information you supply to the Panel in the course of making a submission will only be used for the purpose of assisting in the development of policy advice in relation to this consultation.

19 If you do not wish for your name, or any other personal information, to be included in any summary of submissions that the Panel may publish, please clearly indicate this preference in your response.

Background considerations

Introduction

20 Deal protection devices are obligations that, in a scheme or Code offer, in some way restrict the target's ability to engage with competing offerors and/or impose consequences on a party for not complying with that obligation or otherwise not proceeding with the transaction.

21 Deal protection devices can restrict competition for control of a Code company and prevent shareholders from receiving an opportunity to decide on the merits of a competing proposal by discouraging alternate proposals from being made. In other words, they have the potential to discourage competition for the control of Code companies, conflicting with one of the objectives of the Code.

22 However, because deal protection devices can reduce the potential for further competition, they can be pro-competitive as they can elicit an offer, or an offer on more favourable terms, which may not otherwise be made.[3]

23 This means that deal protection devices can have different effects in different circumstances. Whether a deal protection device is appropriate or not is a fact-specific question depending on the terms of the device and the relevant surrounding circumstances. These factors should be balanced by the target board in each transaction in light of the relevant circumstances. Accordingly, if deal protection devices are regulated, such regulation should provide adequate flexibility, while also providing sufficient clarity and certainty.

Deal protection devices in New Zealand and Australia

24 In New Zealand, deal protection arrangements have been commonly used in schemes, with their terms being incorporated into SIAs, meaning they have been agreed as part of the target committing to put a binding proposal to its shareholders.

25 In Australia, recent transactions have demonstrated the increasing prevalence of pre-transaction deal protection devices. Some of those devices have omitted or limited customary exceptions. These issues have recently come before the Australian Panel, most prominently in *AusNet Services Limited 01* (***AusNet***) and *Virtus Health Limited* (***Virtus***), where the Australian Panel made findings of unacceptable circumstances in relation to deal protection devices. Following these decisions, the Australian Panel released a consultation paper on deal protection devices, and as a result of this consultation it recently published updated guidance on the topic.

Types of deal protection devices

26 Broadly, deal protection devices fall into two categories – exclusivity arrangements and break fee arrangements.

27 Exclusivity arrangements can vary, but key devices may include:

(a) No-shop: the target agrees to not solicit competing offers.

(b) No due diligence: the target agrees to not provide any third party with due diligence access.

(c) No-talk: the target agrees to not engage or negotiate with a competing offeror.

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[3] For example, in the 2021 Tilt Renewables Limited scheme "hard" exclusivity (defined at paragraph 32(c) below) was agreed at the end of an auction process to secure a higher offer from one of the competing bidders.

(d) Superior proposal exception:[4] the target board may engage with a competing offeror only where the competing bid meets specified criteria, usually including that the competing proposal is either a superior proposal or reasonably capable of becoming a superior proposal.

(e) Matching rights: the target agrees that, if a competing offer is made, the original offeror has a right to match or better the competing offer before the target board changes its recommendation or enters into an agreement in relation to the competing offer.

(f) Notification obligation: the target agrees to notify the offeror of, and provide details regarding, any approach made by a competing offeror.

(g) Information obligation: the target agrees to disclose to the offeror any information about the target that is provided to a competing offeror (if it has not already been disclosed to the offeror).

28 In general terms, a break fee is an amount payable by a target to an offeror if specified events occur and the offer fails. Break fees are often described by reference to the events which trigger their payment. They may include the following:

(a) Competing proposal break fee: a fee payable if a competing transaction is completed before the agreement is terminated or within a specified period of time after termination.

(b) No recommendation break fee: a fee payable if the directors of the target company fail to recommend the proposed scheme to their shareholders (this may not apply where the scheme consideration is not within or above the independent adviser's valuation range).

(c) Regulatory approval break fee: a fee payable if certain regulatory approvals (e.g., Commerce Commission approval) are not received.

(d) Naked no-vote break fee: a fee payable if shareholders do not approve the transaction by the requisite margins.[5]

29 Many agreements also include a reverse break fee payable by the offeror in certain circumstances where the transaction does not proceed. As reverse break fees are protections/remedies for the target, the Panel does not consider that they present any significant Code implications, and they are not addressed in this paper.[6]

Voting agreements and lock-up agreements

30 For completeness, the Panel notes that lock-up agreements and voting agreements could also be viewed as deal protection devices. However, the Panel believes that the use of these arrangements in the New Zealand market is well established and accepted. Accordingly, the Panel does not currently intend to reconsider its approach to these.

[4] In other jurisdictions such as Australia, these provisions are commonly referred to as "fiduciary outs" – typically they refer to the directors needing to consider a superior proposal in order to discharge their fiduciary duties to the company.
[5] We note that naked no-vote break fees have been uncommon in public M&A transactions in New Zealand, but include reference in this paper to illustrate the potential effects of break fees generally.
[6] For clarity, there may be issues *related* to the reverse break fee – for example, where the bidder's liability is limited to the amount of the reverse break fee. These issues are not addressed in this paper.

Policy problem

What issues do deal protection devices present?

31 The core policy issue presented by deal protection devices is that, once agreed, deal protection devices can discourage other potential offers, thereby reducing competition for control of a Code company.

32 Various complications arise from deal protection arrangements. Because the deal protection device may have several components, deal protection devices differ between transactions. For example:

(a) An agreement may combine a notification obligation with a matching right. Doing so may remove any practical likelihood that a potential competing offeror will be willing to put a proposal to the target, because the potential competing offeror does not see it as feasible to ultimately outbid the original offeror.

(b) The specific detail of individual components can make the package as a whole more restrictive. For example:

(i) A naked no-vote break fee (see paragraph 28(d) above) may be more restrictive than a regulatory approval or competing proposal break fee.

(ii) Any matching rights may not provide an effective means of considering other proposals. In *Virtus*, for example, the original offeror was able to "match" a competing proposal with a non-binding proposal. This was problematic as the original offeror could effectively block all offers for control without putting forward a binding proposal themselves.

(c) The form of the superior proposal exception will impact on the operation of the deal protection device. In particular, an agreement may provide for a certain period of "hard" exclusivity, where the superior proposal exception is not applicable.

(d) On the other hand, the deal protection device may include several restrictive provisions but encourage competition for control via other specific mechanisms (such as a go-shop provision).[7]

Current regulation of deal protection devices in New Zealand

33 There is no specific rule regulating deal protection devices in public takeovers in New Zealand. There are, however, restrictions which can limit what deal protection devices might be agreed to or enforced. They are summarised below.

[7] Go-shop provisions allow the target a set period in which it can "shop" the market, after which a no-shop obligation will apply.

Defensive tactics in Code offers

34 During (and shortly before) a Code takeover offer, the Code restricts the target from taking actions that might frustrate the offer or have similar effects. Specifically, rule 38 provides:

> ***38 Defensive tactics restricted***
>
> *(1) If a code company has received a takeover notice or has reason to believe that a bona fide offer is imminent, the directors of the company must not take or permit any action, in relation to the affairs of the code company, that could effectively result in—*
>
> *(a) an offer being frustrated; or*
>
> *(b) the holders of equity securities of the code company being denied an opportunity to decide on the merits of an offer.*
>
> *(2) Subclause (1) does not prevent the directors of a code company taking steps to encourage competing bona fide offers from other persons.*

35 Rule 38 is aimed at tactics which undermine a live offer or imminent prospective offer. Examples might include entering into a new contract otherwise than in the ordinary course of business, disposing of key assets or conducting a large capital raise when an offer is imminent or in progress.

36 However, rule 38 is not limited to such examples. Notably, the Panel considered an exclusivity provision in 2003 relating to the control of Tranz Rail Holdings Limited (**Tranz Rail**).[8] In that case, the Panel did not ultimately have to decide the issue as the exclusivity agreement was agreed at the shareholder level and was not an action taken by Tranz Rail's directors, so could not constitute defensive tactics. However, the Panel did note that it considered that the exclusivity clause may effectively frustrate rival offerors.[9]

37 Accordingly, where rule 38 has been engaged, agreeing to deal protection arrangements could constitute defensive tactics and be prohibited by the Code. A simplified example could be as follows:

(a) Offeror 1 issues a takeover notice with the offer terms including a condition that the target does not agree to any other arrangements which might result in a break fee becoming payable to a competing offeror.

(b) Offeror 2 approaches the target board proposing to make an offer, but only on the condition that the target board enters into a pre-bid agreement committing to recommend Offeror 2's offer and agreeing to pay Offeror 2 a break fee if it withdraws this recommendation.

38 Agreeing a break fee in the example may breach rule 38 as Offeror 1 might not make its offer, resulting in that offer being frustrated or shareholders being denied the opportunity to decide the merits of that offer themselves.[10]

39 However, rule 38 is unlikely to apply to all circumstances in which deal protection devices might be agreed:

(a) Rule 38 only applies in relation to a Code offer, not to schemes.[11]

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[8] See https://www.takeovers.govt.nz/transactions/panel-determinations/tranz-rail-holdings-limited/.
[9] See the Panel's determination at paragraph 46.
[10] Note that there would be other issues to address such as whether Offeror 1 could rely on the condition and whether the Panel would grant permission for what would otherwise be defensive tactics.
[11] This is because the triggers of rule 38 are a takeover notice or a bona fide offer being imminent. In a scheme, there is no takeover notice, nor is there an "offer" (offer being defined in the Code and only relating to Code offers, not proposals in relation to a scheme).

(b) The restriction on defensive tactics has limited application where negotiations are incomplete. The earliest rule 38 can apply is when a takeover notice is imminent – this requires something more than an offer being possible to occur in the near future. This means rule 38 might not address deal protection devices at an early stage of negotiation when they might be most impactful.

(c) Rule 38 provides uneven regulation of deal protection devices. Take the example at paragraph 37 above:

(i) Rule 38 might prevent the target directors from entering into a deal protection device in favour of Offeror 2 (as discussed above).

(ii) However, rule 38 might not prevent the target directors from entering into a deal protection device in favour of Offeror 1. This is because Offeror 2 has said it would only make a bid if a deal protection device in its favour is agreed to (an **Offeror 2 Deal Protection Device**). Therefore:

(A) if the target board refused to agree to the Offeror 2 Deal Protection Device, Offeror 2 would never make its offer;

(B) Offeror 2's offer would not be imminent; and

(C) the potential for Offeror 2 to make an offer would not restrict the target board from entering into a deal protection device with Offeror 1.

(iii) This would be a peculiar result. This might be a circumstance where an exclusivity arrangement with Offeror 2 could be justified by the target (if, for example, it would elicit a higher offer).

40 Accordingly, the Panel's view is that rule 38 is not an appropriate or adequate means of regulating deal protection devices. The Panel considers that, if deal protection devices are to be regulated, it would be preferable to implement a new rule focused on the mischief deal protection devices can cause.

Restrictions on deal protection devices in schemes

41 As noted, rule 38 does not apply at all where a scheme is the only transaction structure being contemplated. Deal protection devices may still, however, be subject to oversight in a scheme process:

(a) The Panel may consider deal protection devices when considering whether to grant a No-objection Statement. The Panel might also consider making submissions to the Court in relation to deal protection devices.

(b) Although the Panel is not aware of any New Zealand precedents, the Court might consider deal protection devices under the fourth limb of the test for approval of a scheme set out in *Re Abano Healthcare Group Limited*[12] – i.e., whether the arrangement was such that an intelligent and honest person of business, a member of the class concerned, and acting in respect of his or her interest, might reasonably approve it.

42 To this end, in May 2022 the Panel published a brief *CodeWord* article on deal protection devices. In this article, the Panel expressed the view that it may have concerns where deal protection devices have the effect of inappropriately reducing the potential for competing transactions.

43 However, the Panel considers that guidance and making submissions to the Court might not be sufficient. These mechanisms do not provide a clear means to address unduly restrictive deal protection devices as they

[12] [2020] NZHC 3343.

arise. The Panel would only be able to address them during the Court process, when the competitive advantage has likely already been gained.

<u>Directors' duties</u>

44 Irrespective of transaction structure, directors' duties will be relevant when a target board considers whether to agree to deal protection devices. However, we note that the application of directors' duties is highly fact specific and is an untested area under the Companies Act in the context of control transactions.

<u>Conclusion</u>

45 The Panel's current view is that there are gaps in the regulation of deal protection devices.

Analysis – should deal protection devices be restricted under the Code?

46 In the Panel's view, consideration of this issue should start with the objectives of the Code and whether regulation of deal protection devices would give effect to these objectives. The most relevant objectives of the Code (as set out in section 20 of the Takeovers Act) and the Panel's current views on how they may be achieved (or not) by regulating deal protection devices are set out below.

<u>Encouraging competition for the control of Code companies</u>

47 One objective of the Code is to promote competition for the control of Code companies. This informs aspects of the Code such as the "notice and pause" regime (i.e., issuing a takeover notice before making an offer).

48 The Panel's current view is that this factor favours regulating deal protection devices.

49 The Panel's starting point is that deal protection devices inherently limit competition for control of Code companies. However, in certain circumstances, deal protection devices can encourage competition for control. Accordingly, the objection to deal protection devices is where their effect is, in the aggregate and in light of all relevant circumstances, to inappropriately limit competition for control.

<u>Promoting the international competitiveness of New Zealand's capital markets</u>

50 While New Zealand should not simply look to replicate overseas regimes, it is beneficial for New Zealand regulation of public M&A transactions to be broadly consistent with international practice. This serves another objective of the Code: promoting the international competitiveness of New Zealand's capital markets. International consistency is also a helpful 'cross-check' as it shows how other jurisdictions have struck the balance between competing imperatives.

51 Please see Schedule 1 to this paper for a table comparing restrictions on deal protection arrangements in certain international jurisdictions. There are two broad observations that the Panel has drawn from this survey:

(a) Other comparable jurisdictions tend to have some restrictions on deal protection devices (all jurisdictions compared have, at minimum, guidance on the quantum of break fees that may be payable).[13]

(b) Other jurisdictions do not distinguish between schemes and Code offers (or equivalent transaction types) in regulating deal protection.

[13] The Code generally permits lock-up agreements and the Takeovers Code (Voting Agreements for Schemes of Arrangement) Exemption Notice 2020 allows voting agreements in relation to schemes of arrangement. This differs to many other jurisdictions. Accordingly, bidders in New Zealand may have more options for obtaining deal certainty than relying on deal protection devices alone.

52 The more general conclusion which the Panel draws from international comparison is that New Zealand is out of step with comparable overseas jurisdictions by not restricting break fees, and, to a lesser extent, exclusivity arrangements.

<u>Recognising that the holders of financial products must ultimately decide for themselves the merits of a takeover offer</u>

53 If target boards agree to deal protection devices that reduce the chances of the entrenched proposal failing or a competing proposal arising, then this limits shareholders' ability to decide on the merits of offers themselves. For example:

(a) Overly coercive deal protection devices (e.g., naked no vote break fees) are particularly problematic from this perspective – they effectively penalise the target company, and therefore shareholders, for voting against the transaction. This compromises the neutrality which shareholders might otherwise bring to the decision, reducing the ability to effectively decide on the merits of an offer.

(b) Exclusivity provisions or excessive break fees which limit the potential for other offers to be made necessarily reduce the likelihood of shareholders being able to consider counterproposals.

<u>Other considerations – commercial realities</u>

54 The analysis above suggests to the Panel that there is a case for the Code regulating deal protection devices. However, it is important that the target board retain the power to negotiate appropriate scheme terms.

55 Accordingly, some allowance must be made for target boards to take steps which might result in greater value being delivered to shareholders, including by permitting deal protection devices that would ensure that an offer is made on the most preferable terms possible or that a potential superior competing proposal crystallises into a competing offer.

Conclusions

56 The Panel's preliminary view is that the use of deal protection devices in New Zealand should be regulated to some degree, assuming that an appropriate standard can be developed that provides sufficient clarity while also providing adequate flexibility.

57 As to the detail of this proposal, the Panel's preliminary thinking is as follows:

(a) There may be some benefit in restricting excessive break fees and inappropriate triggers to break fees (bearing in mind that these two issues can interrelate).

(b) As to restrictions on quantum of break fees, the Panel is conscious that there is a generally accepted Australasian standard of 1% of equity value (at least once a transaction has been agreed). The Panel is not aware of any particular issue with this standard, provided that it should not be inflexible. For example:

(i) at an early stage of a transaction (e.g., prior to an SIA being executed) a 1% break fee might be excessive, but a smaller break fee might be justifiable, for example a break fee which relates to actual recovery of a party's expenses (or a reasonable estimate of them); and

(ii) a break fee of more than 1% might be justified in limited situations. These might include:

(A) where the trigger is a deliberate breach and the arrangement is reciprocal – i.e., a deliberate breach by the offeror will trigger payment of a reverse break fee of the same amount; and

(B) where a target is highly geared (and the debt will need to be repaid by the offeror), a break fee of 1% of the enterprise value may be a more appropriate metric.

However, the Panel would appreciate market views on what quantum of break fee might be appropriate in various circumstances.

(c) There is no need to restrict the amount of "reverse" break fees, although the existence of a "parallel" reverse break fee may help justify a break fee that might otherwise be objectionable (see the examples at paragraph 57(b)(ii) above).

(d) The case for restricting exclusivity arrangements is not as strong as the argument for restricting break fees as exclusivity provisions are often more nuanced, making regulation more difficult.

(e) Any restrictions on deal protection devices should apply in the pre-offer/pre-SIA phase (not just after an offer has been made / SIA been entered into).

(f) The same restrictions on deal protection arrangements should apply to both Code offers and schemes. The same mischief of cutting off potential competition seems possible in both an agreed Code offer and in an agreed scheme. It seems unusual that one form of agreed transaction might restrict deal protection devices and one would not.

Questions: Policy problem	
1	Do you agree that deal protection devices should be regulated (assuming that an appropriate standard can be developed)? Please summarise your reasons.
2	Do you agree that if there is to be any regulation of deal protection devices, it should apply to both Code offers and schemes? Please summarise your reasons. In particular, would this unduly undermine the flexibility of schemes?
3	Is there a stronger (or weaker) case for applying restrictions to: • exclusivity arrangements; and/or • break fees?
4	Do you agree that deal protection devices should be regulated prior to the announcement of a transaction / entry into an SIA (or an offer being made)? Please summarise your reasons.

Potential reform

Introduction

58 The Panel considers there to be two potential approaches to the regulation of deal protection devices:

(a) Clarification by guidance only: Under this approach, there would not be any change to the Code or legislation, but the Panel would look to provide guidance to the market.

(b) Law reform: Under this approach, the Panel would look to amend the Code by including a restriction on deal protection devices, with such restriction being applied to schemes as well as Code offers (as to how Code regulation might operate in relation to schemes, see the Regulatory Alignment of Schemes and Code Offers consultation paper, available here). The Panel anticipates that any such restriction would be accompanied by guidance to clarify how the Panel would interpret the rule.

59 The Panel acknowledges that this is a finely balanced issue. However, the Panel's current view is that it would be preferable to progress reform by amending the Code.

Clarification by guidance only

60 In this scenario, there would be no actual law change. Further, the Panel cannot legislate through guidance.

61 However, the Panel could still provide guidance as to:

(a) the circumstances in which deal protection devices might breach current restrictions on defensive tactics – in particular how rule 38 might operate in this context; and

(b) how the Panel might approach deal protection devices in the case of a scheme, including how the existence of certain deal protection devices might:

(i) impact on the Panel's decision to grant a No-objection Statement; and/or

(ii) when the Panel might raise issues with deal protection devices with the Court.

62 While such guidance may provide some clarity, the Panel notes that it would not seek to be prescriptive or overly comprehensive. This is because deal protection is a highly fact-sensitive area, and the permissibility of a particular device can vary depending on the precise circumstances.

63 The issues with, and benefits of, this approach are essentially those set out above: this option would leave a relatively large degree of flexibility with target boards and would help avoid some of the uncertainty which might arise in a fact-sensitive area. However, this approach does not address the identified issues, as there would be no change to the laws that apply to deal protection devices.

Law reform

General approach to content and drafting

64 If a Code rule is introduced to restrict deal protection devices, the Panel expects that:

(a) the restriction would relate to deal protection devices which inappropriately restrict competition for control of a Code company; and

(b) the drafting would be in relatively broad terms so as to allow the rule to cope with differences in:

(i) what a deal protection device might restrict;

(ii) the commercial consequences; and

(iii) the context in which the deal protection device was agreed.

65 In order to clarify how the rule would operate in practice, the Panel would also issue guidance to the market as to its interpretation and to set key expectations. While the Panel does not favour a prescriptive approach (as what is appropriate can vary depending on circumstances), the Panel expects that it would provide guidance as to:

(a) the level of break fee which the Panel considers would typically be so excessive as to not comply with the rule;

(b) the types of break fees which the Panel would generally regard as breaching the rule, e.g., naked no-vote break fees; and

(c) the types of scenarios in which the Panel might accept that "hard" exclusivity complies with the rule – e.g., after an exhaustive auction process (such as occurred in the acquisition of Tilt).

66 In addition, the Panel would be available to discuss proposed exclusivity arrangements with market participants to provide guidance on a case-by-case basis, so that issues could be addressed before commitments were entered into.

Anticipated content of the rule

67 The Panel does not wish to pre-empt how this approach might be captured in drafting. However, the Panel's current thinking is that a rule restricting deal protection devices would be drafted along the lines set out in paragraphs 9 and 10 of the Australian Panel's recently revised Guidance Note 7 (the **Australian Guidance**).

68 Essentially, these paragraphs set a general standard – target boards are expected "to reject deal protection devices that individually or in aggregate have the effect of reducing meaningful competition for control". The Australian Guidance then proceeds to set out a frame of reference for how the Australian Panel will assess deal protection devices and key criteria that the Australian Panel will take into account.

69 The Panel expects that a rule restricting deal protection devices would set outer boundaries of what might be permissible. Notwithstanding these outer boundaries, any proposed deal protection device would have to be assessed to ensure it was appropriate in light of the relevant circumstances (noting that whether or not a deal protection device is appropriate or not is very fact specific). In responding to the questions below, we suggest respondents consider paragraphs 9 – 15 of the Australian Guidance (available here).

Further clarification to be provided in guidance

70 The Panel expects that, if a rule as described above was introduced, the Panel would publish guidance clarifying how the Panel would interpret that rule.

Conclusions

71 While the issue is finely balanced, the Panel favours the proposed reform. The Panel considers that the proposal would give effect to the objectives of the Code and would strike an appropriate balance between

certainty and flexibility.

Questions: Potential reform	
5	Do you consider that the Panel's proposed approach is sufficiently clear while also providing adequate flexibility? Please explain why or why not.
6	Is there any alternative approach which might strike a more appropriate balance between clarity and flexibility?
7	If a rule on deal protection devices was introduced, are there any matters (e.g., "bright lines") which should be set out in the rule itself?
8	Are there any standards that should apply to break fees (e.g., a restriction on quantum to 1% of deal value and/or a restriction on triggers)? If there are any such standards: • What are they? • In what circumstances should these standards *not* apply? • Should they be addressed by rules or by guidance issued by the Panel?
9	Should there be guidance to clarify the circumstances in which a superior proposal exception will generally be expected? When do you consider a superior competing proposal exception would not be required?
10	In what circumstances do you consider a "no shop" provision might be acceptable? For how long might it be permissible for any such restriction to apply?
11	Should a target board ever be required to conduct an auction process? If a target board has conducted an auction process how much more leeway should the target board be afforded in providing exclusivity to the preferred offeror?
12	What relevance do reverse break fees have in considering the appropriateness of break fees? Are they irrelevant? Or, can "mirroring" break fees help justify break fees? Should break fees be "mirrored" by reverse break fees (and, if not, in what circumstances is this not necessary)?
13	Should the Panel look to address any other matters related to deal protection devices (e.g., lock-up or voting agreements)? If so, how should these matters be addressed?

Schedule 1: International approaches to deal protection devices

Note: This table only summarises direct regulatory restrictions. It does not address other limitations on exclusivity and break fees – for example, limitations which may arise through the application of directors' duties or contractual limitations on damages. In addition, it does not address general regulatory restrictions on defensive tactics which might also limit exclusivity provisions and break fees.

Jurisdiction	Break fees		Exclusivity
	Maximum quantum	**Restrictions on triggers**	
Australia	1% of the value of the target is generally not unacceptable (absent other factors). If a break fee is agreed in respect of a non-binding proposal, the quantum is expected to be substantially lower than for an equivalent binding proposal.	The Australian Panel may consider the following factors (among other things): (a) Whether the fee was agreed after a public, transparent process designed to elicit proposals. (b) Whether the proposal was solicited by the target. (c) Whether the fee is fixed or capped. (d) Whether the fee is less than the premium under the bid. (e) The cost, effort or risk involved in making the proposal. (f) Whether the fee reimburses actual expenses. (g) Whether another bidder has increased/made a bid and whether the fee was material in determining the competing bidder's price. (h) Whether the obligation is limited to a reasonable period.	The anti-competitive effect of exclusivity arrangements may be increased when coupled with notification obligations or matching rights. Conversely, the anti-competitive effect may be reduced where exclusivity arrangements are coupled with go-shop or market-check provisions. Exclusivity arrangements are less likely to give rise to unacceptable circumstances if the target has conducted an auction or market-testing process before agreeing to it, or where the potential transaction has been in the market for a reasonable period. **No-talk restrictions** In the absence of an effective "fiduciary" out that is available to target directors in practical terms, a no-talk restriction is likely to give rise to unacceptable circumstances. **No-shop restrictions** A simple no-shop restriction generally does not require a "fiduciary" out, although if the wording of the no-shop would restrict the target's ability to respond to an unsolicited proposal/enquiry, the Australian Panel is likely to treat the restriction the same way as a no-talk restriction. **No-due-diligence restrictions** Safeguards (including "fiduciary" outs) applicable to no-talk restrictions apply similarly to no-due-diligence restrictions and analogous restrictions affecting dealings with potential rival bidders.

Jurisdiction	Break fees		Exclusivity
	Maximum quantum	Restrictions on triggers	
United Kingdom	Must be de minimis, normally no more than 1% of the value of the deal.	Prohibited under rule 21.2(a) (except with the consent of the Panel). Exception normally granted only if the break fee is entered into either (i) to induce a "white knight" competing offeror or (ii) as part of a "formal sale process" and, in each case, is capable of becoming payable only if an offer becomes or is declared unconditional.	Generally prohibited (except with the consent of the UK Panel). In addition, targets are generally under an obligation to provide equal information to competing offerors if there has been a public announcement of an offer. The restriction is quite broad – even restrictions on the conduct of the target's business prior to the offer becoming unconditional are generally prohibited. The Panel may grant an exception if there has been a formal sale process.
Singapore	Must be de minimis, normally no more than 1% of the target (calculated by reference to the offer price).	The target board and its financial adviser must provide written confirmations to the Securities Industry Council regarding the break fee, including that the break fee is in the best interest of target shareholders.	An offeror cannot restrict the target board from taking any action to respond to an unsolicited competing offer, as this would constitute a breach of the target board's fiduciary obligations as well as its obligations under the Singapore Code relating to frustration of offers.
Hong Kong	Must be de minimis, normally no more than 1% of the value of the deal.	The target board and its financial adviser must provide written confirmation to the Securities & Futures Commission that they believe that the break fee is in the best interests of shareholders.	It is normally not acceptable for a target company to enter into any exclusivity agreement that may have the effect of restricting its ability to discuss or negotiate with other potential offerors. Any information given to one offeror or potential offeror must, on request, be provided equally and promptly to another offeror or bona fide potential offeror. The other offeror or potential offeror should specify the questions to which it requires answers. It is not entitled, by asking in general terms, to receive all the information supplied to its competitor.
South Africa	Must be no more than 1% of the value of the deal.	No express prohibition, but actions designed to "impede, frustrate or defeat" an offer are not permitted.	Not directly restricted. However, this is an untested area and we understand that there might be challenges in enforcing exclusivity provisions.

Schedule 2: Table of consultation questions

Consultation Questions: Deal protection devices	
Policy problem	
1	Do you agree that deal protection devices should be regulated (assuming that an appropriate standard can be developed)? Please summarise your reasons.
2	Do you agree that if there is to be any regulation of deal protection devices, it should apply to both Code offers and schemes? Please summarise your reasons. In particular, would this unduly undermine the flexibility of schemes?
3	Is there a stronger (or weaker) case for applying restrictions to: • exclusivity arrangements; and/or • break fees?
4	Do you agree that deal protection devices should be regulated prior to the announcement of a transaction / entry into an SIA (or an offer being made)? Please summarise your reasons.
Potential reform	
5	Do you consider that the Panel's proposed approach is sufficiently clear while also providing adequate flexibility? Please explain why or why not.
6	Is there any alternative approach which might strike a more appropriate balance between clarity and flexibility?
7	If a rule on deal protection devices was introduced, are there any matters (e.g., "bright lines") which should be set out in the rule itself?
8	Are there any standards that should apply to break fees (e.g., a restriction on quantum to 1% of deal value and/or a restriction on triggers)? If there are any such standards: • What are they?

Consultation Questions: Deal protection devices	
	• In what circumstances should these standards *not* apply? • Should they be addressed by rules or by guidance issued by the Panel?
9	Should there be guidance to clarify the circumstances in which a superior proposal exception will generally be expected? When do you consider a superior competing proposal exception would not be required?
10	In what circumstances do you consider a “no shop” provision might be acceptable? For how long might it be permissible for any such restriction to apply?
11	Should a target board ever be required to conduct an auction process? If a target board has conducted an auction process how much more leeway should the target board be afforded in providing exclusivity to the preferred offeror?
12	What relevance do reverse break fees have in considering the appropriateness of break fees? Are they irrelevant? Or, can “mirroring” break fees help justify break fees? Should break fees be “mirrored” by reverse break fees (and, if not, in what circumstances is this not necessary)?
13	Should the Panel look to address any other matters related to deal protection devices (e.g., lock-up or voting agreements)? If so, how should these matters be addressed?