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Capital Markets Practice

Reform of the UK Takeover Regime
Corporate Finance

Introduction

Welcome to the latest in our series of regular alerts containing a round-up of news from our capital markets practice. In this issue, we focus in more detail on the changes to the Takeover Code coming into force on 19 September 2011 which we have referred to in past editions of this publication.

Background

In June 2010, following concerns raised primarily as a result of the takeover of Cadbury Plc by Kraft Foods, Inc., the Takeover Panel ("the Panel") launched a detailed consultation in respect of the application of the Takeover Code ("the Code") to UK takeover offers. The Panel has now published the final text for the amended rules, which will apply to takeover bids with effect from 19 September 2011.[1]

The changes are intended by the Panel to re-dress the balance in favour of target companies and their boards. In particular, the Panel's aim is to give greater protection to target companies in the context of protracted and unsolicited "virtual bids" which are increasingly common (where a bidder announces that it is considering making an offer but does not firmly commit to doing so). It is too early to say whether the changes have tipped the balance too far in the target's favour and, in particular, whether the new regime will deter certain bidders from making offers, or possible offers, for UK PLCs.

The Panel has also sought to provide enhanced protection for third parties (i.e. in addition to target shareholders) interested in the result of a takeover bid, including for example the employees of target companies and their employee representatives.

It remains to be seen how these changes will affect the strategy and process for proceeding with a takeover offer, both from the perspective of the bidder and the target. We will monitor the situation and up-date you as market practice develops.

The new regime

The new regime will apply to offer periods starting on or after 19 September 2011. Transitional arrangements will apply for offers or potential offers live on that date.[2]

The key changes to be made to the Code include the following:

- ***Announcement to identify all potential bidders:*** where an offer period commences as a result of an announcement by the target, all potential bidders with whom the target is in talks or from which the target has received (and not unequivocally rejected) an approach must be identified (Rule 2.4 (a)). Related rules include the following:
    - potential bidders cannot require that a target keep an approach or the name of a potential bidder confidential: Rule 2.3(d);

1 The new rules (and an explanation for their application) are set out in the Panel's Response Statement RS 2011/1, available at: http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/RS201101.pdf. New edition of the Code, effective 19 September 2011, available at: http://www.thetakeoverpanel.org.uk/wp-content/uploads/2009/01/Code_190911.pdf'

Most of the changes being implemented are those proposed by the Panel in its Public Consultation Paper 2011/1 (available at: http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/PCP201101.pdf), with only some relatively minor amendments and clarifications.

2 The transitional arrangements are set out in Panel Statement No. 2011/18, available at: http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/2011-RS.pdf .

- any subsequent announcement by a target which refers to the existence of a new potential bidder, must name that potential bidder, unless the announcement is made after another bidder has announced a firm intention to make a bid for the target: Rule 2.4(b); and

- if, during an offer period, rumour and speculation specifically identify a potential bidder not previously named in an announcement, the Panel will usually require the publication of an announcement identifying the potential new bidder: Note 3 to Rule 2.2. This effectively reverses historic practice by the Panel.

- ***"Put up or shut up" ("PUSU") deadline automatically imposed on potential bidders identified in the announcement:*** under Rule 2.6(a), a potential bidder will have until 5pm on the 28th day after the date of the announcement either:

  - to announce a firm intention to make an offer (under new Rule 2.7); or

  - to announce that it does not intend to bid (under Rule 2.8) – in which case the potential bidder would be ruled offside from making an offer for at least six months subject to certain exceptions,

  unless the PUSU deadline is extended.

  PUSU deadlines may only be extended with the consent of the Panel. The Panel will consider all relevant factors (including the status of negotiations and the anticipated timetable to the announcement of a firm offer) and an extension will only be granted at the request of the target (Rule 2.6(c)). The Panel would normally only grant such consent shortly before a deadline is due to expire: Note 1 to Rule 2.6.

  Target boards may, in theory, agree to, or request, different PUSU deadline extensions for different potential bidders (Note 1 to Rule 2.6).

- ***"Down tools" exemption - dispensation from the requirement for an announcement where a potential bidder ceases to consider making an offer:*** the Panel may grant a dispensation from the requirement for an announcement identifying a potential bidder, if it is satisfied that a potential bidder has ceased to actively consider making an offer for the target (including ceasing all related preparations and analysis). In such a case, unless exceptional circumstances apply and the Panel consents to the recommencement of negotiations, the potential bidder will be ruled offside from actively considering a bid for a period of 6 months i.e. as if it had made a statement under Rule 2.8: Note 4 on Rule 2.2. Currently, the informal time bar applied by the Panel is three months.

- ***Dispensation from PUSU deadline for a formal sale process:*** the Panel will normally be prepared to grant a dispensation from the requirement to name potential bidders and from the application of PUSU deadlines, where an announcement is made by the target starting an offer period (or even after an offer period has started) which also states that the target is seeking to attract one or more potential bidders for the target by means of a formal sale process: Note 2 on Rule 2.6. In such cases, these dispensations will only apply to those potential bidders taking part in the formal sale process.

- ***Changing the level or nature of the offer consideration:*** new provisions make it clear that once a bidder has announced a firm intention to make an offer, it is not permitted to exercise any right it had previously reserved to set aside a statement either in relation to the level of consideration to be offered or in relation to varying the form and/or mix of the consideration: Note 1 on Rule 2.5.

- ***Break fees and other deal protection measures:*** there is a general prohibition on the agreement or use of deal protection measures and break fees. The target and its concert parties may not, therefore, without the consent of the Panel, enter into an "offer-related agreement" with a bidder, potential bidder or its concert parties during an offer period or when any offer is in reasonable contemplation: Rule 21.2(a). In particular, this change will usually prohibit break fee/ inducement fee agreements, non-solicitation/ exclusivity agreements and implementation agreements (which have become very popular in the context of takeover

offers by way of scheme of arrangement).

There are, however, certain exceptions to the general prohibition. These fall into two categories:

- o firstly, those exceptions set out in Rule 21.2(b), which include:
  - commitments in relation to confidentiality agreements;
  - commitments to assist in obtaining any necessary regulatory clearances;
  - undertakings relating to non-solicitation of employees, customers or suppliers;
  - irrevocable commitments and letters of intent (given by directors, acting in their capacity as shareholders, and by other shareholders);
  - other arrangements imposing obligations only on bidders and their concert parties, other than in the context of a reverse takeover; and
  - any agreement relating to an existing employee incentive scheme, and
- o secondly, those exceptions which may be available with the Panel's consent which include:
  - the payment of an inducement fee to one or more "white knights" after a third party has announced a firm intention to make a hostile offer where:

    (a) the total value of the inducement fees payable to white knights is de minimis (i.e. not more than 1% of the offer value (calculated by reference to the first new competing bidder's offer)); and

    (b) the inducement fee is payable only where another offer becomes wholly unconditional: Note 1 on Rule 21.2; and
  - where, prior to a firm offer being announced, the target confirms it is entering into a formal sale process, the Panel may agree to the target entering in to an inducement fee arrangement with one potential bidder who has participated in the sale process, at the time such potential bidder announces its firm intention to make an offer, subject to the provisos set out in paragraphs (a) and (b) above: Note 2 on Rule 21.2.

- ***Schemes of Arrangement:*** where an offer is firmly announced by way of a scheme of arrangement and the target board has agreed to include a statement of recommendation in that announcement, the target and the bidder must, subject to certain exceptions, agree and adhere to a timetable for effecting the scheme: Section 3 of Appendix 7. Additional protections are provided to bidders, allowing them to include offer conditions providing for a takeover scheme to lapse where the shareholders' court meeting and/or the court sanction hearing to approve the scheme are delayed by more than 21 days past the dates originally intended for such meeting or hearing.
- ***Factors to be considered by the target board when providing its opinion on an offer:*** the new Code expressly provides that there are no limits on the factors that a target board may take into account when giving its opinion of an offer. Specifically, the target board is not required to consider the offer price as a determining factor: Note 1 on Rule 25.
- ***Disclosure of offer-related fees and expenses:*** both the target and the bidder will be required to disclose the following details where relevant to them:
  - o an estimate of the aggregate fees and expenses (and other "costs and expenses") expected to be incurred in relation to an offer;
  - o a breakdown of the aggregate amount by category of adviser – such as financial advisers; brokers; solicitors; accountants; PR advisers and "other professional advisers", including management consultants, actuaries and specialist valuers; and
  - o an estimate of the fees and expenses expected to be incurred in relation to financing an offer (but not the fees and margins in relation to hedging arrangements), with such information to be set out in the offer document, in the case of the bidder (Rule 24.16(a)),

and in the target board circular, in the case of the target (Rule 25.8).

The Panel must be notified if any estimated figure is to increase by 10% or more and may require public disclosure of the revised figure. The same procedure will apply in cases where the final fees and expenses actually paid exceed the relevant estimated maximum figure by 10% or more: Rule 24.16(c); Rule 24.16(d) and Rule 25.8.

- ***Increased disclosure of financial information in relation to a bidder and the financing of the offer, irrespective of the nature of the offer:*** as part of the enhanced disclosure requirements under the new Code, the new provisions include the requirement that the bidder disclose full financial information in respect of itself on a website as standard, whatever the form of the offer – for example, even in the case of a wholly cash offer by way of scheme of arrangement: Rule 24.3. Now only two years' (as opposed to the previous requirement of three years') worth of audited figures need to be referred to (in addition to any recent interim or preliminary announcement of financial information). Additional disclosure is also required in respect of the debt and equity financing of offers by bidders and any refinancing of the debt or working capital facilities of the target: Rule 24.3(f).

- ***Disclosure of a bidder's intentions regarding the target company and its employees:*** the increased disclosure requirements will apply to all offers, including cash offers. A bidder will, for example, be required to state in its offer document, amongst other matters, its intentions with regard to the future business of the offeree company and explain the long-term commercial justification for the offer (Rule 24.2(a)) and must also continue to disclose: its intentions in relation to the on-going employment of employees and management of the target group, including any material change to their conditions of employment; and its strategic plans for the target, and their likely repercussions on employment and the locations of the target's places of business: Rules 24.2(a) (i) and (ii). If no changes are intended or there will be no such repercussions, bidders will need to include a negative statement. The Panel has also indicated that it expects to see more specific disclosure on these matters, particularly where a offer is recommended and the bidder has had the opportunity to do due diligence on the target. As a result of making these disclosures, there could be implications for a party in respect of such statements of intent (as discussed in the next paragraph).

- ***Parties regarded as 'committed' to statements of intent:*** a party to an offer who makes a statement of intent as to the course of action it intends to follow after the end of the offer period will, unless there has been a material change in circumstances, be treated as committed to the course of action for a period of 12 months after the end of the offer period or for such other period as specified in the statement: Note 3 on Rule 19.1. Failure to comply may result in the Panel bringing disciplinary action. There is no express definition of a "material change in circumstances" and it will be interesting to see how the Panel defines or interprets such an event, should this issue arise in practice.

- ***Engagement with employee representatives:*** the Panel is keen to increase a target's engagement with its employees and its employees' representatives and to allow a greater opportunity for employees and their representatives to make their views known. A number of changes have been made in this regard, including: the right for target employee representatives to provide publicly their own opinion on the effects of an offer on target employee arrangements, not only (as historically) at the point at which an offer document (or a target board circular) is published, but also at any point thereafter, up until fourteen days after an offer has become or been declared wholly unconditional, with such opinion to be published on the target's website; an express provision which requires the target to pay the reasonable costs incurred by employee representatives in obtaining advice in relation to the verification of the contents of their opinion on the impact of the offer; and requirements for the target to remind employee representatives of their right to provide their own opinion on the offer and that their reasonable costs, in verifying such opinion, will be paid for by the target: Rules 25.9 and 2.12(d).

- ***Display of documents:*** the new rules set out the requirements for the display of certain documents following the announcement of a firm intention to make an offer (as opposed to, historically, only following the publication of an offer document). These include a provision that parties need now only display documents on a website (rather than physically): Rules 26.1 and 26.2.

How Squire Sanders Hammonds can help

We would be pleased to discuss with you in more detail any of the matters raised in this alert.

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