



Panel consultation on regulation of takeover bids

This briefing summarises the arguments for and against various possible changes to the Takeover Code (as set out by the Takeover Panel) and where other actions would be needed to implement the suggestions put forward. The Panel is asking for comments by 27 July 2010.

Acceptance condition thresholds

At present, bidders must have 50 per cent plus one of the target's voting rights before an offer can be declared unconditional as to acceptances. It has been suggested that this be raised to 60 per cent or two-thirds. The Code also requires a person to make a mandatory offer if they (and their concert parties) acquire interests in 30 per cent or more of the voting rights or have between 30 per cent and 50 per cent and acquire more interests in shares. The '50 per cent plus one' condition reflects the fact that a shareholder with this holding can ensure ordinary resolutions are passed.

Lord Mandelson has suggested there is a case for raising the voting threshold for securing a change of ownership to two-thirds, and some believe this would maximise the chance that an offer will only succeed if a majority of long-term shareholders are in favour of it. Against this is the fact that, under current UK law, a shareholder with more than 50 per cent can control the board as well as control other decisions and raising the acceptance condition could leave shareholders locked into a company controlled by another person. If the acceptance condition were raised, the Panel thinks the acceptance condition for mandatory offers should also be considered and whether the level for mandatory offers and voluntary offers should be kept in line or not. There are also a number of other points to consider on mandatory offers, and the levels for other resolutions required by the Code (eg to approve special deals under Rule 16 or actions that would otherwise be frustrating action under Rule 21).

If the acceptance level is raised, the government would need to consider whether the level for passing ordinary resolutions should also be raised.

Disenfranchising shares acquired in an offer period

It has been suggested that shares acquired during a bid be disenfranchised so they would carry no voting rights until the offer period is over. At present shares acquired during a bid have the same rights as all other shares. Bids made by way of a contractual offer can be accepted without exercising voting rights, but bids made by way of a scheme of arrangement can only succeed if the relevant numbers of target shareholders vote in favour of the scheme.

It is argued that disenfranchisement would ensure short-term shareholders would not unduly influence a bid, that it would also reduce the number of short-term speculators acquiring shares in target companies and encourage existing shareholders to take a long-term view of their holdings. However, this suggestion seems to be contrary to the Takeover Directive requirement to treat shareholders of the same class equally and could lead to a smaller group of existing shareholders determining the outcome of a bid. It might also deter potential white knights from buying shares and making a competing offer. It would also be easy for a potential buyer to get round the proposal by agreeing with an existing shareholder how they will vote and behave.

If the disenfranchisement approach were adopted, there are a number of consequential amendments to be considered, including what 'disenfranchisement' would mean, the effect on mandatory offers, how bids effected by a scheme of arrangement should be dealt with, the effect on stock lending and the effect on disclosures under the Code and the Disclosure and Transparency Rules. Any change would probably need a change to company law.

Another suggestion would be to prevent all shares from acquiring voting rights until they have been held for a certain period (eg 12 months) or to give shares that have been held for a certain period additional voting rights. Although this would meet the requirement of equal treatment, there are still issues about how nominees are to be treated, whether avoidance is too easy and the fact that the number of voting rights would change from time to time, that would need to be addressed.

Disclosures

It has been suggested that the threshold for disclosing dealings and positions in securities during a bid be reduced from 1 per cent to 0.5 per cent. Lowering the threshold would give greater transparency, albeit at some extra cost to those concerned, although it might be argued that the benefits would outweigh the costs. The contrary view is that the 1 per cent threshold is sufficient. There is a question as to whether more disclosure necessarily means better disclosure and whether it can be satisfactorily policed. It is also suggested that shareholders should have to disclose when they accept an offer or how they have voted on a bid by way of a scheme of arrangement. This would enable all to see when a particular institution has accepted a bid (providing potentially useful information to beneficial owners) and might help assess the likelihood of an offer's success.

However, there are queries about whether the Panel should be regulating the relationship between institutional shareholders and beneficial owners and some believe that shareholders are entitled to keep their decision on acceptance or voting secret. The Panel could instead require a bidder to provide more information on acceptance levels throughout a bid. If this idea is pursued, the Panel would need to consider when disclosures must be made and whether interests via derivative instruments should be disclosed.

Often the decisions in respect of particular shares are made by different people: for example, a fund manager can decide on dealings and acceptance of an offer, a third party voting service decides on voting decisions and the beneficial owner may be able to give instructions on how to act. The Panel is asking if there should be more clarity in such cases about the different parties involved.

Offer documents and target board circulars

The Code already requires information about offer financing, financial information on the bidder (with more information required if the bidder is offering securities) and quantified effects statements. The main purpose is to enable target shareholders to decide if they want to be shareholders in the bidder – but some may think there is a wider purpose in requiring the bidder to provide information and that shareholders receiving cash, target directors, employees and competing bidders are all interested in this information.

Others believe that bidders should have to give more detail about their intentions in relation to the target. The Code already requires some information on this and the target board must express its views on the offer (reflecting Directive requirements). Some take the view that the information provided is not sufficiently detailed. The Panel could issue a practice statement on the level of detail expected.

The Code does not set out what factors the target board should consider before expressing a view on the offer. In practice, the board normally focuses on the price offered. The Code could, for example, make it clear that directors can take account of other factors (in the same way as under their statutory duty under section 172 of the Companies Act 2006) in recommending what action to take. In practice, few employee representative opinions have been sent with target board circulars. The Code does not prevent bidders or targets communicating information on an offer to employee representatives, subject to their accepting normal confidentiality conditions.

The Panel is seeking views on what disclosure should be required, whether this should differ depending on the type of bid, the level of detail appropriate and the matters the board should consider when deciding whether to recommend a bid.

Advice, advisers and advisory fees

A target board must receive independent advice and must make this known to target shareholders when it gives its opinion on an offer. The Code contains rules on who can be an independent adviser, including that a fee that is payable only if an offer fails normally creates a conflict of interest that disqualifies an adviser. However, it is generally not thought that a fee that is payable if an offer completes or if an offer completes above a certain price creates such a conflict of interest.

It has been suggested that target shareholders (rather than target directors) should receive independent advice, that fees dependent on the outcome of a bid should be restricted and that bidders and companies should have to publicly disclose fees and costs payable to advisers in relation to a bid.

There might be significant difficulties in requiring an adviser to advise all shareholders as they will not know the position of each shareholder. Advisers to the target board have access to information that may not be public and this might not be available to advisers to the shareholders. In other jurisdictions where independent advice is required, this is normally given to the target board rather than direct to shareholders.

On success fees, the question is whether there is a risk of creating a conflict of interest or whether a success fee is in target shareholders' interests as it may encourage the negotiation of a higher price for the target shareholders and ensure a fee is not payable if the bid does not succeed.

On disclosure of advisers' fees, it is argued that they should be disclosed as material contracts and so that any incentive to persuade the bidder or target to pursue a particular course of action is made public. However, this may result in sensitive information about offer tactics being revealed and it may be thought that the Panel's rules on independence offer sufficient protection on potential conflicts of interest already. If the proposal is adopted, the Panel would need to consult on the details, including what fees should be disclosed (all or only some) and whether estimated fees should be required at the outset of a bid or only final figures once a bid has completed or lapsed.

Protection for bidder shareholders

Lord Mandelson suggested that all companies making significant bids in the UK should have to put their plans to their own shareholders. It has also been suggested more focus on this is needed because of the potential effect on the bidder and its shareholders.

Broadly speaking, the Code applies to offers for UK companies, wherever the bidder is located, but does not apply to bids by a UK company for a non-UK company. Under the Listing Rules, a bidder with a premium listing (wherever incorporated) must seek shareholder approval if the bid is classified as a 'Class 1' transaction. The Panel's review of 16 jurisdictions found that bidders are not normally required to obtain independent advice on a bid, although in the US a bidder board may obtain a fairness opinion, even though not required to do so. There is also a question as to whether UK law or regulations should seek to afford protections to shareholders of non-UK companies not otherwise subject to UK regulation.

The Panel is interested in views on whether bidders should be required to offer their shareholders protection and, if so, what form this should take, which companies should be caught and in which cases, and whether the Panel, Financial Services Authority (FSA), the government or another regulatory body should be responsible.

Actions before a bid is made

The Panel regulates the timetable within which a bid must be made. A bidder must normally publish its offer document within 28 days of announcing a firm intention to make a bid. It has become more usual for potential bidders to make statements before announcing a firm intention to make a bid, often with a view to testing the attractiveness of a possible offer and putting pressure on the target board to engage in talks. Such announcements are often referred to as 'virtual bids'. The Panel seeks to balance the principle that a target board must not deny its shareholders the opportunity to decide on the merits of an offer and the principle of not creating false markets against the principle that a target must not be hindered in conducting its affairs by a bid for longer than is reasonable.

Since 2004, at any time after the announcement of a possible offer when the potential bidder has been named, a target company can ask the Panel to impose a deadline by which the potential bidder must either announce a firm intention to make an offer or announce it does not intend to make an offer – so-called ‘put up or shut up’. This is normally within six to eight weeks, although it depends on the facts of the case. It is suggested that the deadlines for put up or shut up are too long and should be standardised (subject to some exceptions) or shortened and that the practice of requiring shorter deadlines for potential bidders that voluntarily make a ‘bear hug’ possible offer announcement should be codified. They might also apply automatically whenever a potential bidder is identified. Shortening the period could, however, deny target shareholders the chance of considering a bid if the potential bidder cannot make a bid announcement by the shorter deadline. It has also been suggested that a potential target could apply for a deadline after receiving an approach (even if an announcement has not been made) and that the approach and deadline would be kept private. Arguably, this would help the bidder’s management, which is constrained in the action it can take when a bona fide bid may be imminent, although against this it is suggested that a target board can disclose the potential bidder’s existence and seek a put up or shut up deadline. Some may think it is disproportionate to require a company to put itself into play in this way in order to seek a deadline.

Possible offers may include pre-conditions (including subjective ones) but must make it clear that there is no certainty any offer will be made, while firm offers can only include objective conditions. The Panel is seeking views on whether announcements of possible offers should be prohibited because of the risk of misleading shareholders that an offer will be made and the risk of siege to the target and, if announcements of possible offers are allowed, whether pre-conditions should be allowed.

The suggestion that bidders should have to post their offer documents more quickly than the 28 days currently allowed raises questions about whether there should be any difference between cash and other offers, whether it should be affected by whether a put up or shut up deadline has been imposed, and the position where subsequent competing offers are made (and whether

the current approach of the first bidder moving onto the timetable set by the later bidder should be changed, or whether this would deprive target shareholders of competing bids).

Inducement fees and other protection measures

It has been suggested that these can frustrate potential competing offers and that target boards may, in practice, be unable to resist agreeing them. Against this, prohibiting them may mean that bids will not be made. The Code permits inducement fees for no more than 1 per cent of the target’s value, calculated by reference to the offer price, provided the target and its financial adviser confirm they believe it is in shareholders’ best interests. It is argued these have now become a standard feature of recommended takeover offers and there is little true negotiation on them. Conversely, it is said that it provides a potential bidder with protection for its costs and, in practice, has not deterred competing bidders.

It has become increasingly common for bid parties to enter implementation agreements, particularly in the context of a bid by way of a scheme of arrangement. Typically, these have target obligations to progress the scheme and impose a timetable and restrictions on the target business to ensure value is not lost, while a bidder may undertake to be bound by the scheme and waive certain conditions before the court hearing. Implementation agreements may also contain specific deal protection measures, such as non-solicitation undertakings and obligations to notify the bidder of an unsolicited approach.

It is suggested that disclosure of inducement fee arrangements and implementation agreements should be made either from commencement of the offer period or when the agreement is made. It is also suggested that companies should always be allowed – or possibly required to have – an ‘out’ where the directors’ fiduciary duties would require them to change a recommendation. However, some take the view that arguments about whether a ‘fiduciary out’ can be relied on in a particular case would lead to court action, which would be undesirable in the course of a bid. Views are also sought on whether deal protection measures do frustrate competing offers being made and whether this could

be cured by allowing the measures to fall away if an inducement fee is paid.

Substantial acquisitions of shares

From 1980 to 2005, the Panel had rules governing the substantial acquisition of shares (SARs). These regulated stake building in companies subject to the Code below the level at which 'control' is deemed to pass. They restricted the speed at which a stake could be built up and required accelerated disclosure when shares or rights over shares were acquired, subject to some exceptions. When the Panel consulted on their abolition, it concluded that they no longer served a useful purpose.

It has been suggested that this be reconsidered to give the target board more time in which to react, to discourage market raids (although these are relatively rare) and to improve disclosure. If the SARs were reintroduced, the Panel would need to consider whether they would need to extend to acquisitions of interests in shares, including economic interests.

Conclusion

The wide scope of the questions raised by the Panel and the fundamental issues they raise in some cases means that all those interested in the regulation of takeovers in the UK will want to take time to consider how best to balance the various competing interests before responding to the consultation.

The issues raised also concern the FSA and the government, who will also watch the outcome of the consultation closely. It is important that all interests are properly represented in the responses. Please contact us if you would like any help in responding to the consultation.

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