Panel pushes forward with significant changes to the Takeover Code

On 21 March 2011, the Code Committee of the Takeover Panel ("**Panel**") published its consultation paper containing detailed rule changes to the City Code on Takeovers and Mergers ("**Code**") so as to implement the proposed changes which it announced on 21 October 2010. That announcement followed the Panel's June 2010 consultation launched in the wake of the controversy surrounding Kraft's takeover of Cadbury last year. Our alert "Some significant changes to the Takeover Code - the end of the road for inducement fees?" summarises the Panel's October 2010 announcement. Comments on today's consultation paper are due by 27 May 2011.

Some of the changes are aimed at reducing the perceived tactical advantage that hostile bidders have over a target company while others are designed to improve the offer process and to take more account of the position of persons who are affected by takeovers in addition to target shareholders. The Panel has proposed changes to the Code to meet four objectives and this alert summarises some of the proposed changes in that context.

Objective 1: protecting targets against protracted "virtual bid" periods

The Panel wants potential bidders to clarify their position within a short period of time. This should help protect targets against bidders who announce they are considering making an offer, but do not actually do so. Under the proposals, a potential bidder will have to be named in the announcement which starts an offer period. A named bidder will then have 28 days to: (i) announce a firm intention to make an offer; (ii) announce that it will not make an offer; or (iii) apply jointly with the target for an extension to the deadline. Where a target has initiated a formal sale process, the Panel will normally grant a dispensation from the relevant rules.

An announcement which begins an offer period must identify all potential bidders in discussions with the target or from whom the target has received an approach. Once an offer period has started, a new potential bidder won't have to be named as a matter of course. But, if the new potential bidder is identified through rumour and speculation, their identity should be disclosed. If the target itself wants to mention the existence of the new potential bidder in an announcement, it must name that bidder.

Each potential bidder should be subject to its own deadline – so, if the identities of two or more potential bidders are announced on different days, they will be subject to different deadlines. If the target wants a common deadline for all possible bidders, it will have to request deadline extensions as appropriate.

The Panel will take all relevant factors into account when considering a request for an extension to the deadline, but it is expected that consent will normally be granted if requested by the target board. The Panel may consent to different extensions for different potential bidders, or consent to an extension for some but not others. The Panel will normally give its decision shortly before the relevant deadline is due to expire, not at the outset of the 28 day period.

The 28 day deadline will not apply where another bidder has announced a firm intention to make an offer. This is consistent with the way the "put up or shut up" regime currently works.

These changes are likely to incentivise unnamed bidders from leaking details of their potential offers to the market: there is no need to name a bidder if there has not been an announcement which begins an offer period. So, if there has not been rumour and speculation or an untoward movement in share price, and there is no other "trigger" for a possible offer

announcement, there will be no need to name publicly a potential bidder. Potential bidders may be put off if they run the risk of being publicly named at an early stage in the process (and through no fault of their own). However, the Panel's view is that the benefits of publicly identifying all possible bidders outweigh the risk that bidders might be deterred from making an offer.

The Panel is proposing to amend the definition of "offer period" to provide greater clarity as to the types of announcement that will begin and end an offer period.

Objective 2: strengthening the target's position

The Panel believes that the proposed general prohibition on deal protection measures and inducement fees should extend to any "offer-related arrangement" to be entered into between the target and a bidder (or persons acting in concert with them) in connection with an offer. An "offer-related arrangement" will be broadly defined and catch a variety of agreements, arrangements and commitments including, for instance, implementation and exclusivity agreements. The Panel has also elaborated on the matters to be excluded from the scope of this prohibition and these will include arrangements which impose obligations only on a bidder (e.g. a reverse break fee or a standstill agreement) and irrevocable undertakings.

The Panel is proposing a new dispensation from this prohibition to allow a target to pay an inducement fee to a so-called "white knight". The Panel acknowledges that where a hostile bid has been announced, the target board might want to seek a potential competing bidder and that the target should be permitted in certain circumstances to agree an inducement fee arrangement with just one competing bidder when that bidder announces a firm intention to make an offer.

In the context of a scheme of arrangement, implementation agreements will no longer be allowed. Instead, the Panel is planning to amend the Code to provide that, where the target board agrees to its recommendation being included in the bidder's announcement of a firm intention to make an offer by means of a scheme, the target must ensure that the scheme circular is sent to shareholders within 28 days of that announcement (unless the target board subsequently withdraws its recommendation). The target must also ensure that the circular sets out the expected timetable for the scheme. The target must implement the scheme in accordance with that timetable unless:

- the target board withdraws its recommendation;
- the target board announces its decision to propose an adjournment of a shareholder meeting or court sanction hearing; or
- a shareholder meeting or the court sanction hearing is otherwise adjourned.

If subsequently the target board wishes to announce a new timetable, the bidder must approve the new timetable. The target must then promptly announce the new timetable and implement the scheme in accordance with the new timetable unless any of the above exceptions apply.

Where one of these exceptions apply, or the Panel considers the target has not implemented the scheme in accordance with the published timetable, the Panel will normally allow the bidder to switch to a contractual offer with an acceptance condition set at up to 90% of the shares to which the offer relates.

The Panel is also planning to amend the Code to make it clear that the Code does not limit the factors that the target board may take into account in giving its opinion on an offer. In particular, when giving its opinion, the target board is not required by the Code to consider the offer price as the determining factor and is not precluded by the Code from taking into account any other factors which it considers relevant.

Objective 3: increasing transparency and improving the quality of disclosure

Under the proposals, the bidder and target will have to disclose their estimated aggregate fees and expenses incurred in connection with the offer, as well as the estimated fees and expenses incurred in relation to financial and corporate broking advice, financing arrangements, legal advice, accounting advice, PR advice, other professional services (including management consultants, actuaries and other specialist valuers) and other costs and expenses.

In the case of variable fee arrangements, estimates of the maximum and minimum amounts payable should be disclosed. Where the fee is uncapped (for example if the fee relates directly to the final value of the offer or will be calculated on a "time cost" basis) an estimate should be given together with an indication of the nature of the arrangement. If the arrangement sets out circumstances in which the fee will increase (for example where an offer is revised or a competitive situation arises), the higher amount will not have to be disclosed unless and until those circumstances arise.

Where the fees and expenses payable (or actually paid) within a particular category are likely to exceed materially (or have exceeded materially) the estimated maximum amount disclosed, this must be disclosed to the Panel. The Panel may require public disclosure of the revised estimate or final amount, as applicable.

The Panel is also planning to require increased disclosure in relation to the bidder's financials and financing of the offer, irrespective of the nature of the offer. Detailed financial information on the bidder will have to be disclosed in all offers, not just securities exchange offers. An exception to this is changes in the financial or trading position since the last accounts, which will not be required for a cash offer. Offer documents will have to include details of the website address where the audited accounts, interim statements and preliminary announcements of the parties for the last two financial years (a reduction from the current three year requirement) have been published. These will then be treated as having been incorporated into the offer document by reference.

All offer documents will need to contain details of ratings and outlooks publicly accorded to the bidder and the target before the offer period, any changes during the offer period and before publication of the offer document, and the reasons given for those changes. The Panel is not taking forward its earlier proposal to require a pro forma balance sheet of the combined group.

Additional disclosure will also be needed in relation to financing of the offer, and all documents relating to the financing arrangements for the offer will need to be put on display. Display documents will need to be published on a website but will no longer need to be available for inspection. Certain documents (including relating to the financing of the offer, and irrevocable undertakings) will need to be published on a website from the time of the announcement of a firm intention to make an offer, rather than from the time the offer document or target circular is published.

Objective 4: providing greater recognition of target employees' interests

The Panel is proposing changes to the Code to improve the quality of disclosure in relation to the bidder's intentions regarding the target and its employees. A key change here is that bidders will have to make negative statements if they do not plan to make any changes in relation to, or their strategic plans will have no repercussions on, the continued employment of the employees and management, the strategic plans for the target and the target's fixed assets. A bidder will also be required to state its intention in relation to the maintenance of any existing trading facilities for the target securities, since this can be an important factor for shareholders in making their decision on an offer.

Parties to the offer will be expected to stand by any public statement made during the offer period (whether in a document, announcement or otherwise) relating to any course of action it intends to take (or not take) after the end of the offer period. This goes further than the proposals announced in October last year, which just related to statements made in offer documents. Where no time period is specified, the statement will normally be expected to hold true for at least 12 months from the date on which the offer becomes or is declared wholly unconditional.

The Panel is also proposing changes to the Code to improve the ability of employee representatives to make their views known. This includes making it clear that the Code does not prevent the passing of information to employee representatives during the offer period and requiring target boards to inform employee representatives at the earliest opportunity of their right under the Code to circulate an opinion on the effects of the offer on employment. Where their opinion is not received by the target board in time to be included in the target circular, the target board will have to publish the employee representatives' opinion on a website and announce that it has been published, provided it is received within 14 days of the offer becoming or being declared unconditional. The target will be responsible for costs reasonably incurred, including any advice required for verifying the information in the opinion.

If you have any questions or require specific advice on any matter discussed in this alert, please contact:

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