

Takeover Code changes published - is this a new era for UK takeovers?

On 21 July 2011, the Code Committee of the Takeover Panel (“**Panel**”) published the detailed rule changes to the City Code on Takeovers and Mergers (“**Code**”) implementing changes which it first proposed last year. The rule changes will take effect on Monday, 19 September 2011 (“**Implementation Date**”).

Some of the changes are aimed at reducing the perceived tactical advantage that hostile bidders have over a target 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 generally adopted the draft rules published in March 2011 without material amendment.

The Panel’s objectives are to:

- protect targets against protracted “virtual bid” periods;
- strengthen the target’s position;
- increase transparency and improve the quality of disclosure; and
- provide greater recognition of target employees’ interests.

This alert looks at some of the changes, and how they may impact on Code transactions. Transitional arrangements are also summarised where appropriate.

Naming a potential bidder

Key rule changes

An announcement by a target on or after the Implementation Date which begins an offer period must identify any potential bidder with which the target is in talks or from which an approach has been received (which has not been unequivocally rejected by the target).

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 announce the existence of the new potential bidder, it must name that bidder.

A dispensation from this requirement to name potential bidders may be available where a formal sale process is initiated - see “Formal sale process” for further discussion.

Transitional arrangements

If a target is already in an offer period on the Implementation Date, the target will have until 5.00 pm on that date to name any potential bidder with which it is in talks, or from which it has received an approach, if it was in talks with or had received an approach from that potential bidder at the start of the offer period. The target will also be required to identify any potential bidder to whose existence it has referred in any announcement it has made since the start of the offer period and with which it remains in talks. This requirement to name a potential bidder will not apply where another bidder has announced a firm intention to make an offer for the target before the Implementation Date.

Comment

These changes are likely to deter unnamed bidders from leaking details of their interest in a target to the market: there is no need to name a potential bidder if there has not been an announcement which triggers 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 (such as extending discussions to more than a very restricted number of people), there will be no need to name publicly a potential bidder. However, the new rules give rise to a number of concerns:

- 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), with the effect that they either decide not to make an approach to the target at all, or they elect to withdraw should a leak occur. A potential bidder may prefer to drop out of the process rather than run the risk of being associated with a “failed” bid. This may be a particular concern for private equity bidders, but is also relevant to other potential bidders; and
- there have been suggestions that a bidder which is at an advanced stage in its bid preparations could use the new rules to its advantage to flush out any competition - if information about the first bidder were to be leaked which prompts the need for a possible offer announcement, any other potential bidders will either have to be named publicly, or withdraw.

If a potential bidder is in talks with or has made an approach to a target, and that target is in an offer period on the Implementation Date, the potential bidder should consider whether the target is required to name it publicly under the transitional arrangements described above, and if so, whether it is willing to be publicly named as a potential bidder or whether it will instead withdraw from the process.

A potential bidder must “put up or shut up”

Key rule changes

Any potential bidder first identified on or after the Implementation Date will have 28 days to either: (i) announce a firm intention to make an offer; or (ii) announce that it will not make an offer, unless the Panel has consented to an extension of the deadline. This is often referred to as a put up or shut up, or PUSU, deadline.

The 28 day deadline will not apply or will cease to apply if another bidder has already announced, or subsequently announces (before the relevant deadline) a firm intention to make an offer for the target. This is consistent with the way the put up or shut up regime currently works.

Each potential bidder will 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 normally consent to an extension of the PUSU deadline if requested to do so by the target board and after taking account of all relevant factors including the status of negotiations between the target and potential bidder and the anticipated timetable for completion. A target board may request different deadline extensions for different potential bidders, or an extension for one potential bidder but not others.

A dispensation from this requirement to “put up or shut up” within 28 days may be available where a formal sale process is initiated by the target board - see “Formal sale process” for further discussion.

Transitional arrangements

If a target is already in an offer period on the Implementation Date, any potential bidder which has been identified in an announcement on or before that date (including any potential bidder named on the Implementation Date to comply with the transitional arrangements described under “Naming a potential bidder”) will have until 5.00 pm on Monday 17 October 2011 to (i) announce a firm intention to make an offer; or (ii) announce that it will not make an offer, unless the Panel has consented to an extension to the deadline. This will not apply where another bidder has announced a firm intention to make an offer before either the Implementation Date or 5.00 pm on 17 October 2011.

Comment

Given the relatively short timeframe in which potential bidders will have to announce a firm intention to make an offer, any potential bidder will need to be relatively far advanced in its bid preparations before approaching the target.

Bidders undertaking pre-approach due diligence, or looking to advance financing discussions pre-approach, will need to be careful about the number of parties they enter into discussions with - if the bidder extends discussions to more than a very restricted number of people (the “six person” rule), this could in turn force it to make an early announcement and start the 28 day period.

If a bidder is not in a position to announce a firm intention to make an offer within the 28 day period, it will either have to pull out, or ask the target to apply for an extension to the deadline. 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 Panel’s reasoning for making a decision towards the end of the 28 day period is that:

- the status of negotiations will change during the period, and the Panel wants to be able to make its decision on the basis of the status of negotiations at the end of the period; and
- granting an extension at the beginning of the period will not reduce a bidder's tactical advantage over a target. Granting an extension at the end of the period helps redress the balance in favour of the target.

The 28 day timeframe could prove a challenge on complex transactions, particularly those which have a cross-border element, involve share exchange consideration, or involve complex financing arrangements. In many cases, it will be clear from the outset that the 28 day period will be very difficult, or even unachievable. A potential bidder will then have to decide whether to spend time and money advancing its bid preparations in the knowledge that these will be wasted if the Panel does not grant an extension towards the end of the 28 day period. Aside from the wasted resources, there is also reputational risk with being associated with a "failed bid". A potential bidder may prefer to withdraw from the process rather than be seen to spend time and money on a bid where the current timetable is unachievable and there is no guarantee that the timetable will be extended. This may be a particular concern for private equity bidders, but is also relevant to other potential bidders.

Formal sale process

New rules will not apply to a formal sale process

Before a bidder has announced a firm intention to make an offer in relation to a target, if the target board announces that it is seeking one or more potential bidders by means of a formal sale process, the Panel will normally grant a dispensation from the requirements (i) to name potential bidders and (ii) for them to "put up or shut up" within 28 days.

See "General ban on offer-related arrangements" in relation to inducement fee arrangements that may be entered into in the context of a formal sale process.

Comment

This is a logical and appropriate exception but may be of little use in practice. It will not apply if (as is not uncommon) targets want to keep their options open and refer to a range of options which might include a formal sale process, rather than tie themselves specifically to a formal sale process.

General ban on offer-related arrangements

Key rule changes

A general ban on deal protection measures and inducement fees will be introduced, with certain limited exceptions. This ban will extend to any "offer-related arrangement" between the target and a bidder (or persons acting in concert with them) in connection with an offer. An "offer-related arrangement" is broadly defined and will catch a variety of agreements, arrangements and commitments including, for instance, implementation, exclusivity and break fee agreements. This general ban on deal protection measures and inducement fees is a reversal of developments which have taken place in recent years.

Matters excluded from the scope of this prohibition include:

- confidentiality undertakings (although these must not contain other provisions which are themselves prohibited under the Code, such as provisions preventing the target board from publicly identifying the potential bidder);
- a commitment not to solicit employees, customers or suppliers;
- a commitment to provide information or assistance in relation to obtaining regulatory clearances;
- irrevocable commitments and letters of intent;
- any agreement or arrangement which imposes obligations only on a bidder (other than in the context of a reverse takeover), such as a reverse break fee or a standstill agreement; and
- any agreement relating to any existing employee incentive arrangement.

In the case of a hostile offer, the Panel will normally consent to a target entering into an inducement fee arrangement with one or more "white knight" bidders, as long as the aggregate amount of inducement fees that may be paid by the target is de minimis (i.e. normally no more than 1% of the value of the target) and is only payable if an offer becomes or is declared wholly unconditional.

In the case of a formal sale process, the Panel will normally grant a dispensation from the prohibition to allow a target to enter into an inducement fee arrangement with one bidder at the time of its announcement of a firm intention to make an offer. Again, this must be de minimis and only payable if an offer becomes or is declared wholly unconditional.

Transitional arrangements

The general ban on inducement fees and other offer-related arrangements will apply with effect from the Implementation Date. Any inducement fee or other offer-related arrangement entered into before that date will not be subject to the ban.

Comment

It will be interesting to see the extent to which deal protection measures are used in the run up to the Implementation Date. As the Implementation Date moves closer, it may be increasingly difficult for bidders to insist on the usual suite of deal protection measures. Target boards will have to consider very carefully before agreeing to any deal protection measures which will be banned from the Implementation Date.

With the prohibition of deal protection measures, there may be a greater focus on other measures to secure a bidder's position, such as stakebuilding (which has become easier following the 2006 abolition of the Rules Governing the Substantial Acquisition of Shares). Contractual offers may again become more popular than schemes of arrangement, as stakebuilding is more effective in the context of a contractual offer.

Schemes of arrangement

Key rule changes

As already mentioned under "General ban on offer-related arrangements", implementation agreements will no longer be allowed. Instead, the Code will 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 and bidder will be allowed to agree the following as conditions to the scheme:

- a long-stop date by which the scheme must be implemented; and
- a specific date by which the shareholder meetings and court sanction hearing must be held (unless extended by agreement between the bidder and target). The dates must be no more than 21 days after the expected date of the relevant meeting, as set out in the scheme circular.

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 (subject to any changes announced by the target) 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;
- a shareholder meeting or the court sanction hearing is otherwise adjourned; or
- any condition to the scheme (including a condition as to the long-stop date and dates for the shareholder meetings and court sanction hearing referred to above) is invoked by the bidder in accordance with the Code.

Where one of these exceptions applies, 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.

Transitional arrangements

If a bidder announces a firm intention to make an offer to be implemented by means of a scheme, and the announcement is made before the Implementation Date, the current rules will apply. If the announcement is made on or after the Implementation Date, the new rules will apply.

Comment

Schemes of arrangement have become the more common deal structure in recent years. Although the scheme process is run by the target, bidders have sought to obtain a degree of control over the scheme process through the use of implementation agreements. Whilst bidders will lose some of this control, the new rules will provide them with the comfort they previously enjoyed through contractual measures, but without all the excesses that have developed to the disadvantage of the target.

Offer documents and target board circulars

Key rule changes

Various changes are being made in relation to the contents of offer documentation, in particular the offer document and the target circular. 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 financing arrangements, financial and corporate broking advice, 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 (or have exceeded) the estimated maximum amount disclosed by 10% or more, this must be disclosed to the Panel. The Panel may require public disclosure of the revised estimate or final amount, as applicable.

Increased disclosure will also be required in relation to the bidder’s financials and financing of the offer, irrespective of the form of consideration payable under 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 end of the last financial period for which either audited financial information or interim financial information has been published, 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, and a statement that the accounts, interim statements and preliminary announcements have been incorporated into the offer document by reference to the website.

All offer documents will need to contain summary details of ratings and outlooks publicly accorded to the bidder and the target before the offer period, any changes during the offer period, and a summary of the reasons given for those changes.

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 earlier than is the case now, namely by 12 noon on the business day following the announcement of a firm intention to make an offer, rather than from the time the offer document or target circular is published.

Transitional arrangements

If the initial offer document is published before the Implementation Date, the offer document, target board circular and any other documents published in relation to the offer will have to comply with the current provisions of the Code (even if the target board circular or any revised offer document is published after the Implementation Date). Where the initial offer document is published after the Implementation Date, the offer document and any subsequent offer documentation will have to comply with the provisions of the revised Code.

Comment

From a practical perspective, there may be an incentive for bidders to publish their offer document before the Implementation Date. If it looks like the offer document may not be published before the Implementation Date, it may be advisable to take an early decision that it will be published after the Implementation Date and work on the basis that it will need to comply with the new rules.

The target board’s opinion on the offer

Key rule change

The Code will be amended 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 Code will make it clear that the target board is not required 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.

Transitional arrangements

The target board’s opinion will be set out in the target’s circular, and the transitional arrangements set out under “Offer documents and target board circulars” will apply.

Comment

The change is a clarification rather than a substantive rule change and is unlikely to have a big impact on target board opinions.

Improving the ability of employee representatives to make their views known

Key rule changes

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.

If a party to the offer makes a statement in a document, announcement or other information published in relation to an offer relating to any course of action it intends to take (or not take) after the end of the offer period, they will be regarded as being committed to it for 12 months from the date on which the offer period ends, or such other period of time as is specified in the statement, unless there has been a material change of circumstances.

Changes are also being introduced to improve the ability of employee representatives to make their views known. The revised wording of the Code makes it clear that the Code does not prevent the passing of information to employee representatives during the offer period. Target boards will be required 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. If 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 via an RIS that it has been published, so long as it is received no later than 14 days after the date on which the offer becomes or is declared wholly unconditional. The target will be responsible for costs reasonably incurred, including any advice required for verifying the information in the opinion.

Transitional arrangements

Where an employee representatives' opinion is not received in good time in order to be appended to the target circular, the target will have to publish the employee representatives' opinion on a website and announce via an RIS that it has been published, and to pay for the costs incurred. This will apply from the Implementation Date, even if the offer document to which the opinion relates is published before that date.

Comment

Statements of intention will have to be considered very carefully, including any qualifications to those statements. The Panel recognises that statements of intention and / or negative statements may be made subject to certain qualifications, but considers it is better for a bidder to make a more detailed, but qualified, statement, rather than a general unqualified one.

In due course, the Panel is planning to consider whether the provisions of the Code which relate to employee representatives should be extended to apply to the trustees of the target's pension scheme.

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