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## Update on the UK Takeover Panel's review of the Takeover Code

On 21 October 2010, the UK Panel on Takeovers and Mergers (the Panel) released a response to the feedback it has received to its wide-ranging June 2010 review of a number of basic principles of UK takeover regulation. In its response the Panel has switched its focus from the impact of short-term investors on the outcome of hostile bids to a concern that the present rules in its City Code on Takeovers and Mergers (the Code) unduly favour hostile bidders over their targets and that the position of targets needs strengthening. The changes to the Code that the Panel is now proposing to address this are likely to prove just as controversial as the Panel's possible changes to address its concern about the impact of short-term investors were.

The changes will also apply to recommended transactions and so a bidder considering making a friendly approach to a UK target is going to have to be prepared in future: (1) to go public about its approach and to firm up its bid intentions much earlier than would previously have been the case, and (2) to proceed without the benefit of the usual "no shop" and/or break fee protections that previously it would have expected to receive from the target.

### Key points

- A **potential bidder will now have to be publicly named** in any "possible offer" announcement required under the Code
- Once publicly named, **the bidder will now have just four weeks** in which to announce either a firm (and binding) intention to make a bid or that it will not bid (in which case the Code bars the bidder from making another offer for the next six months)
- **Inducement (or break) fees and other deal protection measures will no longer be permitted**
- **Greater disclosure** will be required of:
  - **financial information about the bidder and its financing of the bid**, and this will be required in all bids (and not just paper bids)

- **advisers' fees** and other offer-related (including success) fees
- the Code will include an increased emphasis on:
  - the consideration of **target employees' interests in bids**, and
  - the target board not being required under the Code to consider the offer price as the determining factor in its response to a bid
- The Panel will **not** be proceeding with the most controversial of the possible rule changes it discussed in its June review:
  - raising the minimum voting rights acceptance condition from 50% plus one, and
  - disenfranchising voting securities acquired in the target during an offer period
- At this stage **no draft rule changes have been published**, and it is **unlikely that any of these proposed changes will become effective until some time next year**

### Unlevel playing field?

The Panel justifies its first three key rule changes listed above by claiming that “hostile offerors have, in recent times, been able to obtain a tactical advantage over the offeree company to the detriment of the offeree company and its shareholders” and that the position of targets in takeovers needs to be strengthened. However, market opinion seems to be far from unanimous on this point, and there must be a concern that some of the rule changes now announced may have the unintended effect of tilting the playing field too much in favour of the target.

### Virtual bids and the Code's “put up/shut up” rule

The Code requires an announcement to be made in a number of situations before a would-be bidder has determined to proceed with a bid, including where, following an approach, the target is the subject of rumour or speculation or there is an untoward movement in its share price. Currently, such “possible bid” announcements need not name the potential bidder who is in talks with the target.

The Code also allows a target that finds itself under a protracted and distracting siege from a potential bidder after the announcement of a possible bid but before any firm intention to make a bid has been announced, to request the Panel to put an end to this “virtual bid”. The Panel can set a deadline (usually six to eight weeks) in which the bidder must either announce a firm intention to make a bid or to announce it will not bid (in which case the Code will bar it bidding for the next six months). This is the so-called “put up/shut up” rule.

The Panel is proposing two changes to deal with this “virtual bid” problem. One is to require the potential bidder to be publicly named whenever an announcement is required under the Code that a possible offer may be made. The other is to require the bidder to declare its intentions, one way or the other, within a fixed period of four weeks from being named in the announcement. Bidder and target will also be permitted to apply jointly to the Panel for an extension of this four week timetable.

These changes to the “put up/shut up” rule will not apply to targets that have put themselves up for sale through a formal auction process. The Panel has also said that, in an exceptional case, it could consider setting a private “put up/shut up” deadline for a bidder where no announcement of a possible offer has yet been made but where the target can persuade the Panel that it is nevertheless subject to an “unacceptable level of siege”.

This fixing of a four-week deadline under the “put up/shut up” rule is likely to prove controversial, not the least because one of the justifications for introducing it is the Panel's perception that target boards have been reluctant to make use of the “put

up/shut up” rule for fear of appearing self-serving or overly defensive. If that really is the case, it must be questioned whether introducing the rigidity of a potentially much shortened pre-bid timetable is the best way (or even an appropriate way) of dealing with this. Other concerns include the increased leverage that targets will now have over potential bidders to force them to come up with an offer at a much earlier point in their negotiations than would previously have been the case.

#### No more inducement (or break) fees or other deal protection arrangements

The other key change proposed to redress the balance in takeovers between bidder and target may prove less controversial, although the Panel notes that a majority of the respondents to its review were in favour of the Code’s existing rule permitting inducement fees that do not exceed 1% of target value. The effect of no longer permitting targets to agree to pay inducement fees or to bind themselves to take action to implement an offer or not to take any action that might facilitate a competing offer, is intended to encourage more competing offers and so to benefit target shareholders. However, this change would also prohibit “no shop” clauses which restrict targets from actively soliciting (but not from receiving) competing offers following an announcement. In the absence of such protection, a potential bidder would risk becoming a public “stalking horse” and so may be reluctant to offer its highest price, potentially to the detriment of the target’s shareholders.

As with the “put up/shut up” rule change, this prohibition will not apply to targets that have put themselves up for sale through a formal auction process but will apply to private negotiated transactions.

The prohibition will not prevent targets from agreeing to standard confidentiality and no-poaching arrangements with bidders or agreeing to provide information required for regulatory clearances. In addition, the Code will be amended to require targets who have agreed to an offer being made by a scheme of arrangement, to implement the scheme in accordance with the timetable for it agreed with the Panel, subject only to the target withdrawing its recommendation for the bid.

#### Increased financial disclosure for bidders

Although opinion was apparently evenly split on whether the Code should require further disclosure of financial information relating to the bidder in offers, the Panel is proposing that detailed financial information should be provided, irrespective of whether the offer is a cash or a securities offer. Currently, much less financial information on the bidder is required where its bid is a cash only bid.

Where the bid is “material”, the offer document will have to include:

- a pro-forma balance sheet of the bidder’s combined group, and
- details of the bidder’s ratings and changes that will arise as a result of the offer.

There will also be greater disclosure required of the bidder’s debt facilities to finance the bid, and all financing documents will have to be put on display.

The Panel is justifying this increased disclosure on the basis that it will be of relevance and assistance to more than just the target’s shareholders; for example, the target board in framing its views on the offer, employees and creditors, etc., of the parties to the offer and the bidder’s shareholders. However, some bidders could find these new disclosure requirements a challenge and, depending on their particular circumstances, possibly a disincentive from making even friendly approaches to UK targets.

#### Disclosure of advisers’ fees

Most respondents to the Panel’s review were in favour of greater disclosure of advisers’ fees in the bidder’s and target’s offer documents, and so the Panel will introduce new rules requiring:

- estimated aggregate fees to be set out by each party in its offer document or circular,

- estimated fees of advisers (including financial advisers, lawyers and PR advisers, etc.) to be disclosed separately by category of adviser and showing the maximum and minimum amounts payable as a result of any success, incentive or ratchet mechanism, and
- financing fees to be disclosed separately from advisory fees.

Parties will be able to exclude from this disclosure any commercially sensitive information about the offer. Any material changes to the amounts disclosed in the relevant documents will have to be announced promptly. What effect this increased transparency will have on the costs of mounting and defending bids remains to be seen.

### The target's employees and its board

The existing Code requires the target's board: to include in its circular with respect to the bid its views on the effects of the offer and of the bidder's strategic plans for the target on its employees, to make the bidder's offer document available to its employee representatives and to include in its circular an opinion of its employee representatives on the effects of the offer on employment. The Code also requires the bidder to disclose in its offer document its strategic plans for the target, their likely repercussions on employment and its intentions with respect to the continued employment of the target's employees.

The Panel is proposing strengthening these target employee protections by the following Code amendments or clarifications:

- requiring negative statements if the bidder has no plans with respect to the target's employees,
- requiring any such statements (positive or negative) to hold true for at least one year following the offer having become wholly unconditional,
- making it clear that the Code does not prevent the passing of information in confidence to employee representatives (in their capacity as such) during the offer period,
- requiring the target board to inform the employee representatives at the earliest opportunity of their right to circulate an opinion on the effects of the bid on employment, and
- requiring the target to publish its employee representatives' opinion on the effects of the offer at the target's expense and also to pay the costs incurred by the employee representatives in obtaining advice reasonably required for the verification of their opinion.

These changes seem worthwhile and, like a proposed restatement of directors' duties which is intended to remind the target board that the Code allows it to think of more than just the offer price when considering its response to a bid, while they are not likely to change the outcome or course of any bids, they are likely to lead to a more serious approach being adopted, for example, to the question of target employee interests.

### What the Panel will not be taking any further

In addition to the most controversial of the issues mentioned in the Key Points above which the Panel will not be pursuing, it will not be taking any further a number of other issues on which it consulted:

- the re-introduction of the SARs (the Substantial Acquisition of shares Rules which used to restrict the ability of potential bidders to mount dawn raids on targets),
- shortening the offer timetable, particularly the 28 days allowed between announcement of a bid and the posting of the offer document, and
- reducing the current 1% threshold for discloseable interests in bidder/target voting securities.

Next steps

The Panel intends to publish in due course one or more further consultation documents on the wording of the amendments to the Code required to introduce the changes that it has announced. It has also said that it intends to return to one issue on which it consulted in June and that is whether the Code's disclosure requirements should be clarified to take better account of the circumstances where the rights attaching to a shareholding have been split up between (say) voting (retained by the beneficial owner of the shares) and offer/acceptance decisions (exercised by the owner's fund manager).

For further information about the Panel's June review, you may wish to refer to our earlier client publication, [Review of the UK Takeover Code](#).

This publication is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

If you wish to receive more information on the topics covered in this publication, you may contact your regular Shearman & Sterling contact person or any of the following:

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