

The Takeover Panel: Further Proposed Changes to the UK Takeover Code

The Panel on Takeovers and Mergers (the Panel) published three public consultation papers on 5 July 2012, inviting comments on proposed amendments to the UK Takeover Code (the Code). The three consultation papers propose changes to the Code concerning the following:

- pension scheme trustee issues;
- companies subject to the Code; and
- profit forecasts, quantified financial benefits statements, material changes in information and other changes to the Code.

Copies of the public consultation papers are available on the Panel's website (see: <http://www.thetakeoverpanel.org.uk/consultation/current-consultations>). Comments on the Panel's consultation papers are due by 28 September 2012. The proposed changes in these consultation papers follow a number of important changes made to the Code in September 2011.

1 - Consultation on Disclosure by Bidders and Targets in Relation to the Bidder's Intentions Regarding the Target's Pension Scheme(s) and Related Matters

The Panel proposes amendments to the Code with the object of creating a framework within which the effects of a bid on the target's pension scheme(s) can be discussed both at an early stage and during the course of the bid, and so that each of the bidder, the target board and the trustees of the pension scheme(s) may express their views.

This consultation paper results from responses submitted by pension scheme trustees and their advisers and representatives to a previous consultation launched by the Panel in June 2010 which proposed that a number of changes be made to the Code to improve communication between the target board and its employee representatives and employees. The proposed changes took effect in September 2011, and have been discussed in previous *DechertOnPoints* (see publications dated [October 2010](#), [April 2011](#) and [October 2011](#)). The Panel received a number of responses as part of that consultation suggesting that changes to the Code be extended so as to also apply to the trustees of the target's pension scheme(s). This consultation has been published as a result of those responses.

The Panel proposes that the Code be amended to require a bidder to state its intentions regarding the pension scheme(s) of the target and its subsidiaries (or a negative statement if it has no intentions in relation to such matters), and the likely consequences on the scheme(s) of its strategic plans for the target.

The Panel proposes that, barring a material change in circumstances, a bidder will be held to any such statement for 12 months (or such other period set out in the statement) from the date on which the offer period ends (in accordance with existing *Note 3 to Rule 19.1*). The Panel notes that if a bidder breaches its commitment, the Panel could take disciplinary action against the bidder, but the pension trustees would not be entitled to bring a claim for damages.

Further, it is proposed that the target board should express, in its circular to shareholders setting out the opinion of the board on the offer and its reasons for forming this opinion, its view on the effects of implementation of the offer and likely consequences of the bidder's strategic

plans for the target on the target's pension scheme(s).

The Panel proposes to amend the Code to provide that an opinion from the trustees of the target's pension scheme(s) on the effects of the offer on the scheme(s) must be appended to the target's circular, or (where the opinion is not received by the target in good time) the target must publish the trustees' opinion on its website and announce via an RIS that it has done so.

The Panel does not, however, propose to impose a requirement on the target to pay costs reasonably incurred by the trustees of the pension scheme(s) in obtaining advice required to verify information in their opinion (whereas *Note 1 on Rule 25.9* currently requires the target to pay costs incurred by employee representatives in verifying their opinion). The Panel states that the costs incurred by trustees of the pension scheme(s) to verify the information contained in its opinion could be significant (as actuarial and valuation analysis could be required). This distinction may have little impact in practice, however, as, a sponsoring company will normally be responsible for paying the costs of trustees of pension schemes.

The Panel proposes to amend the Code to provide that a summary of any agreements entered into between a bidder and trustees of the target's pension scheme(s) should be included in the bidder's offer document, and a copy of that agreement be made available for inspection.

The Panel notes that *Rule 21.2(a)* of the Code (which provides that, other than with the consent of the Panel, a target (or anyone acting in concert with it) may not enter into any agreements which relate to the offer for the target during an offer period or when an offer is reasonably in contemplation) could be seen to prohibit the bidder entering into an agreement with trustees of the target's pension scheme(s). However, the Panel concludes that the prohibition should not apply to such agreements as trustees of the pension scheme(s) are normally independent of the sponsoring company. It is possible to consult with the Panel if doubts remain about the application of *Rule 21.2(a)*.

The Panel has not followed suggestions to impose a deadline on a bidder to reach a definitive position on its funding commitments for the target's pension scheme(s), or, where no such position is reached, to impose an obligation on the Panel to refer the matter to the Pensions Regulator. The Panel stated that to do so would extend the scope of the Code beyond its principal objective of protecting the

target's shareholders. The Panel added it would not be appropriate for the Panel to decide whether clearance from the Pensions Regulator should be sought, and the Panel did not want to extend the scope of the Code beyond providing a framework for discussions of the effects of a bid on the target's pension scheme(s).

Unsurprisingly, the Panel's proposed amendments to the Code set out in this consultation paper have been welcomed by those representing trustees of pension schemes. NAPF (the National Association of Pension Funds which is the body representing interests of pension schemes in the UK) commented that the proposed amendments "*would enable trustees to get much more information about the bidder's intentions for the pension scheme*", which is "*important as it...empower[s] them to ask the right questions and effectively represent the interests of those in the company scheme, both savers and pensioners.*"

Conclusion on Consultation Paper 1

If implemented, the changes to the Code proposed in this consultation paper should improve disclosure of bidders' intentions regarding the target's pension scheme(s) and the target board's opinion on those intentions, and provide trustees of the target's pension scheme(s) with the ability to express their views. Despite concerns that the proposed changes will result in a bidder being required to engage in many consultations to shape its bid to suit all interested parties, the changes should facilitate early and open discussion regarding the target's pension scheme(s), as the respective views of each party should be clear at the beginning of any offer period.

The proposed changes should also protect beneficiaries of a target's pension scheme(s) from unexpected closure of their scheme once a bid has succeeded. The changes do not, however, provide trustees of a target's pension scheme(s) with a say on whether a takeover bid should go ahead or not, or impose an obligation on a bidder to provide a firm commitment on how the target's pension scheme(s) are to be funded if their bid succeeds.

2 - Consultation on Companies Subject to the Code

The Panel has also published a consultation proposing to amend the Code to widen the number of companies subject to the Code through the removal of the residency test.

Currently, the application of the Code to a company which has its registered office in the UK, the Channel Islands or the Isle of Man (the Relevant Territories) but which does not have securities registered for trading on a regulated market in the UK (which includes the Main Market of the London Stock Exchange, but, notably, does not include AIM) or a stock exchange in the Channel Islands or the Isle of Man, may depend on whether that company's place of central management and control is deemed by the Panel to be in the Relevant Territories (*Code Introduction paragraph 3(a)(ii)*). This is commonly referred to as the 'residency test'. When determining a company's place of central management and control, the Panel will assess whether the board of directors of the company (or a majority of them) are resident in the Relevant Territories.

In practice, it can be problematic for a third party to determine whether a company satisfies the residency test (and so whether it is subject to the Code), as the residency of a company's directors is not usually publically disclosed. Further, whether or not a company is subject to the Code may change if the company's directors relocate. The Panel notes that investors (not all of whom will be familiar with jurisdictional requirements of the Code) in a company with its registered office in the Relevant Territories may expect any offers for that company to be subject to the Code, which is not always the case.

The Panel proposes to remove the residency test from the Code, so that a company with its registered office in a Relevant Territory but which does not have securities admitted to trading on a regulated market in the UK or a stock exchange in the Channel Islands or the Isle of Man, regardless of where they are managed and controlled.

However, the Panel may encounter difficulties if application of the Code is widened to apply to companies with offices registered overseas, particularly relating to compatibility of the Code with local laws and the Panels' ability to enforce the Code and its decisions overseas. The Panel states it is aware of concerns regarding shares traded in the UK which are not subject to the Code where the relevant company has redomiciled to an overseas jurisdiction. The Panel states that it intends to investigate "*whether it might be feasible and proportionate for some measure of Code protection to be extended to shareholders in such companies*".

Where a target company does not have a sufficient nexus with the Relevant Territories, it is possible the

Panel may not be able to effectively undertake its regulatory responsibilities. However, the Panel has never used its statutory powers since they were introduced, and has not encountered significant problems regulating the conduct of bidders and potential bidders managed overseas.

The Panel also proposes changes to the Code to clarify when the Code will apply to offers for private companies through amending what is known as the '10-year rule'. The proposals will mean that the only private companies which will be subject to the Code are those whose securities have been admitted for trading on a regulated market or any multilateral trading facility in the UK, or any stock exchange in the Channel Islands or the Isle of Man at any time during the 10 years prior to the relevant date. The proposed changes remove other criteria which created some uncertainty regarding application of the Code in certain circumstances.

Conclusion on Consultation Paper 2

If implemented, the changes to the Code proposed in this consultation paper will result in an increase in the number of companies which will come under the jurisdiction of the Panel, most of which have securities admitted to trading on AIM.

Many such companies may already provide takeover protection similar to the Code for their shareholders through provisions in their articles of association. If the Panel's proposals are implemented and such companies become subject to the Code, if the takeover protection within their articles is inconsistent with the Code, these companies will need to seek shareholder approval to adopt an amended set of articles which do not conflict with the Code.

Another typical characteristic of such companies is that a single person holds a large beneficial interest in the company's shares (often in excess of 30 per cent.). The application of the Code to such companies would mean that should the majority shareholder seek to acquire any additional shares in the company, that shareholder would be subject to the mandatory offer provisions of *Rule 9*.

3 - Consultation on Profit Forecasts, Quantified Financial Benefits Statements, Material Changes in Information and Other Changes to the Code

Many of the proposed changes to the Code apply to *Rule 28*, which relates to profit forecasts made by

bidders and targets. The Panel proposes to change the Code to provide for:

- introducing a number of definitions into the Code, including 'profit forecast' and 'profit estimate', consistent with those terms in the FSA Handbook and the Prospectus Directive Regulation;
- introducing guidance on the compilation of profit forecasts and qualified financial benefits statements (a qualified statement about the expected financial benefits of a proposed takeover or merger), the contents of qualified financial benefits statements, and requirements regarding assumptions. It is also worth noting that this consultation paper proposes that the Panel discusses with the Financial Reporting Council whether a new reporting standard governing quantified financial benefits statements should be developed;
- where a profit forecast is published before an approach is made with regard to a possible offer, the offer document (where the forecast is published by a bidder) or the target's board circular (where the forecast is published by a target) following the offer being made must:
 - (i) repeat the forecast and include
 - (a) confirmations from the directors that the forecast remains valid and a consistent accounting basis has been used, and (b) the assumptions on which the forecast is based,
 - (ii) include a directors' statement that the forecast is no longer valid, with an explanation, or (iii) include a new forecast for the relevant period, consistent with the requirements for publishing forecasts during an offer period (as set out in new *Rule 28.1(a)*);
- where a profit forecast is published following an approach with regard to a possible offer (but prior to an offer), the offer document (where the forecast is published by a bidder) or the target's board circular (where the forecast is published by a target) must repeat the forecast, together with assumptions and reports relating to the forecast;
- where, during an offer period, a profit forecast or qualified financial benefits statement is first published by a bidder (other than a cash bidder) or a target, this must also include:
 - (i) the assumptions on which the forecast or statement is based, (ii) a report from the party's reporting accountants confirming the forecast or statement has been properly compiled, and (iii) a report from the party's financial advisors that the forecast or statement has been prepared with due care and consideration;

- granting the Panel power to grant dispensations from the requirements of the Code relating to publishing forecasts; and
- allaying concerns that the directors of a target subject to a management buy-out offer may use profit forecasts to influence the outcome of an offer.

Further, the Panel proposes to change the Code regarding disclosures of material changes in information. Rather than updating material changes in information previously disclosed only where a subsequent document is published (i.e. where a bidder publishes a subsequent offer document, or the target board publishes a subsequent circular to shareholders) as currently required by the Code, it is proposed that a bidder and target must disclose promptly any material changes in information published in the offer document and circular, respectively, by way of an announcement or (where required by the Panel) the publication of a new document. These proposed new obligations will only apply during an offer period.

Conclusion on Consultation Paper 3

The changes proposed by this consultation paper aim to ensure that what constitutes a profit forecast is more clearly understood and that profit forecasts and qualified financial beneficial statements made by a bidder or a target are prepared to an appropriate standard.

Next Steps

The Panel invites comments on its consultation papers by 28 September 2012. In accordance with the Panel's usual procedures, once the Panel has considered responses to the consultation papers, it will publish response statements, setting out the final text of changes to the Code.

With respect to the proposed changes to the Code relating to companies subject to the Code as discussed at the paragraph entitled '*Consultation on Companies subject to the Code*' above, the Panel intends that such changes will take effect approximately one month after the Panel's response statement is published.

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