PCP 2009/3 Issued on 9 December 2009

THE TAKEOVER PANEL

CONSULTATION PAPER ISSUED BY THE CODE COMMITTEE OF THE PANEL

AMENDMENTS TO RULE 5.2(c)(iii)

Before it introduces or amends any Rules of the Takeover Code (the "**Code**"), the Code Committee of the Takeover Panel (the "**Code Committee**") is normally required under its procedures for amending the Code to publish the proposed Rules and amendments for public consultation and to consider responses arising from the public consultation process.

The Code Committee is therefore inviting comments on this Public Consultation Paper ("**PCP**"). Comments should reach the Code Committee by 29 January 2010.

Comments may be sent by e-mail to:
supportgroup@thetakeoverpanel.org.uk

Alternatively, please send comments in writing to:

The Secretary to the Code Committee
The Takeover Panel
10 Paternoster Square
London
EC4M 7DY

Telephone: 020 7382 9026
Fax: 020 7236 7005

All responses to formal consultation will be made available for public inspection unless the respondent requests otherwise. A standard confidentiality statement in an e-mail message will not be regarded as a request for non-disclosure.

Unless the context otherwise requires, words and expressions defined in the Code have the same meanings when used in this PCP.

1. Executive summary

1.1 Rule 5.1 of the Code restricts a person from acquiring interests in shares in a company when that acquisition would result in him, together with persons acting in concert with him, being interested in shares carrying 30% or more of the voting rights of that company. The primary purpose of Rule 5.1 is, broadly, to provide an opportunity for the board of a company to consider an offer and give advice to its shareholders before effective control can be obtained by a new controller or consolidated by an existing controller. Rule 5.2 sets out certain exceptions to the restrictions in Rule 5.1. In particular, Rule 5.2(c)(iii) provides that an offeror may make acquisitions that would otherwise be restricted by Rule 5.1 after:

(a) the first closing date of its offer or, if earlier, of any competing offer, having passed; and

(b) confirmation having been received that either its offer or (if earlier) any competing offer will not be the subject of a "phase II" investigation by the Competition Commission or the European Commission (unless the offer, or any competing offer, falls outside the jurisdiction of the UK and EC competition authorities).

1.2 The Code Committee believes that it is no longer appropriate for Rule 5 to restrict an offeror from acquiring interests in shares and, consequently, restrict other persons from disposing of interests in shares to the offeror beyond the first closing date of an offer, notwithstanding that uncertainty as to whether there will be a phase II investigation may persist beyond that date. In addition, the Code Committee understands that there are difficulties in establishing with certainty that an offer falls outside the jurisdiction of the UK competition authorities, such that that particular limb of the exception in Rule 5.2(c)(iii) is, in effect, redundant.

1.3 The Code Committee is therefore proposing a partial liberalisation of Rule 5.2(c)(iii), with the result that Rule 5 would no longer impose restrictions on acquisitions of interests in shares by an offeror following the first closing date of its offer (or, if earlier, of any competing offer).

1.4 In addition, the Code Committee is proposing, in due course, to undertake a more general review of Rule 5 in order to establish whether there might be a case for further amending, or deleting, certain (or even all) of provisions of the Rule and would welcome any views on these issues ahead of commencing that review.

2. Proposed amendments to Rule 5.2(c)(iii)

(a) Introduction

2.1 In summary:

(a) under Rule 5.1(a), a person is restricted from acquiring interests in shares which, when aggregated with shares in which persons acting in concert with him are interested, would result in his coming to be interested in 30% or more of a company's shares carrying voting rights; and

(b) under Rule 5.1(b), where a person, together with persons acting in concert with him, is interested in shares which, in aggregate, carry 30% or more of the voting rights of a company but does not hold shares which carry more than 50% of the voting rights, he is restricted from acquiring further interests in shares carrying voting rights in that company

unless, in each case, one of the exceptions set out in Rule 5.2 is applicable.

2.2 The exceptions in Rule 5.2 apply, broadly, where an acquisition:

(a) is from a "single shareholder" and the acquirer has not announced a firm intention to make an offer for the offeree company (Rule 5.2(a)); or

(b) is made immediately before the acquirer announces a firm intention to make an offer for the company, provided that the offer will be publicly recommended by, or the acquisition is made with the agreement of, the board of the offeree company (Rule 5.2(b)); or

(c) is made after the acquirer has announced a firm intention to make an offer for the company (Rule 5.2(c)) and:

(i) is made with the agreement of the board of the offeree company; or

(ii) that offer, or any competing offer, has been publicly recommended by the board of the offeree company (even if such recommendation is subsequently withdrawn); or

(iii) the first closing date of that offer (or of any competing offer) has passed (under Rule 31.1, the first closing date of an offer must be not less than 21 days after the offer document is published) and either:

(1) it has been announced/established that the offer (or any competing offer) is not to be the subject of a phase II investigation by either the Competition Commission or the European Commission; or

(2) the offer (or any competing offer) does not come within the statutory provisions for possible reference to the Competition Commission and does not come within the

scope of Council Regulation 139/2004/EC (the "**EC Merger Regulation**"); or

(iv) that offer is unconditional in all respects; or

(d) is made by way of acceptance of the offer (Rule 5.2(d)); or

(e) is permitted by Note 11 on Rule 9.1 ("The reduction or dilution of interests in shares") or Note 5 on the Notes on Dispensations from Rule 9 ("Shares carrying 50% or more of the voting rights") (Rule 5.2(e)).

2.3 In summary, and subject to the exceptions, the primary purpose of the restrictions in Rule 5 is, once a firm intention to make an offer has been announced, to provide an opportunity, prior to the first closing date, for the board of the offeree company to consider the offer and give advice to the company's shareholders before effective control of the company can be obtained by a new controller or consolidated by an existing controller. As was stated in Panel Statement 1985/7, which announced the introduction of Rule 5 in broadly its present format, "Rule 5 essentially prevents a unilateral offeror from taking its holding of shares and rights over shares to 30% or more until after the first closing date".

(b) History of Rule 5.2(c)(iii)

(i) Rule 41(3) of the pre-1985 Code and the 1985 restructuring of the Code

2.4 Prior to the introduction of Rule 5 in April 1985, acquisitions of shares and rights over shares through the 30% threshold were restricted by old Rule 41(3). The press statement which described the introduction of the old Rule 41, issued on 21 January 1982, summarised the rule as follows:

> "… In future an offeror will not be allowed to buy beyond 29.9 per cent of the shares of the target company until after the first closing date stated in its formal offer document. The purpose of this change is to ensure that an offeror cannot by-pass the safeguards contained in the Take-over Code by moving too swiftly to a controlling position.".

An earlier press statement, issued on 24 September 1981, had stated as follows:

> "… it is undesirable that effective control of a company should change hands in a matter of hours before all shareholders are aware of what is happening and before the Board of the target company has had a chance to comment or to up-date market information.".

2.5 In April 1985, the Code was substantially revised and restructured into its current format. The new Rule 5.1 was introduced, in substance, in the same terms as the present Rule 5.1, as described above. The new Rule 5.2(c)(ii) (which later became Rule 5.2(c)(iii)) provided that the restrictions in Rule 5.1 did not apply to an acquisition of shares or rights over shares by a person who had announced a firm intention to make an offer (the posting of which was not, or had ceased to be, subject to the fulfilment of any condition) if the first closing date of that offer or of any competing offer had passed.

(ii) The 1989 amendments to Rule 5.2(c)(iii)

2.6 In November 1988, the Panel asked a Working Party, chaired by Lord Rockley, who was at the time the Chairman of the corporate finance committee of the British Merchant Banking and Securities Houses Association, to report to the Panel as to whether various proposals for amending the rules governing takeovers should form the basis of amendments to the Code. One of the issues considered was whether the relationship between first closing dates and decisions of the Office of Fair Trading (the "**OFT**") created unfair or false markets.

2.7 Panel Statement 1989/10, which summarised the Working Party's conclusions in relation to each of the issues considered, stated as follows:

> "Under Rule 5 a unilateral offeror may only acquire 30% or more of the offeree company by buying shares in the market following the first closing date. When an offer comes within the statutory provisions for possible reference to the Monopolies and Mergers Commission, the Secretary of State indicates, if possible by the first closing date, whether he proposes to make a reference, in which event, of course, the offer automatically lapses. However, when the Secretary of State has not so indicated, the offeror can be assisted by the resulting uncertainty in increasing its holding to strategically significant levels.
>
> Accordingly, the Panel has decided that Rule 5 should be amended, so that, in those cases where the statutory provisions apply, a unilateral offeror can only acquire 30% or more of the offeree company once the Secretary of State's decision is known, if this is later than the first closing date. The Rule is also amended to include provision for competing offers. The Panel will be able to permit the amendment of the offer timetable at its discretion if the Secretary of State's decision is significantly delayed.".

2.8 Shortly thereafter, following the entry into force on 21 September 1990 of the predecessor to the present EC Merger Regulation, Rule 5.2(c)(iii) was brought into essentially the form in which it appears in the Code today.

(c) Competition reference uncertainty as a reason for restricting acquisitions

2.9 As indicated above, the primary purpose of Rule 5 is to provide an opportunity for the board of the offeree company to consider an offer and give advice to the company's shareholders before effective control of the company can be obtained or consolidated. The effect of Rule 5.2(c)(iii) is that, in the case of a unilateral offer, the minimum period of time afforded to the offeree board will normally be 21 days and (unless the offer does not come within the statutory provisions for possible reference to the Competition Commission or the scope of the EC Merger Regulation), where merger clearance has not been received by the first closing date, this minimum period of time is, in effect, extended until the date on which it is confirmed that the offer will not to be the subject of a phase II investigation by the Competition Commission or the European Commission.

2.10 As also indicated above, the original rationale for extending the restrictions of Rule 5.1 beyond the first closing date for a unilateral offer was to prevent the offeror from taking advantage of the uncertainty that might be created by the outstanding possibility of a competition reference in order to put the outcome of the offer beyond doubt, for example by purchasing shares though the 50% threshold, at which point the offer would become unconditional.

2.11 Whilst acknowledging that this might have been an appropriate rationale for extending the restrictions of Rule 5.1 at that time, the Code Committee questions whether it continues to be an appropriate rationale today. Whilst it may be true that the outstanding possibility of a competition reference might lead to the offeree company's shares being traded at a discount to the price at which they might otherwise be traded, the Code Committee does not believe that this is an adequate reason for restricting an offeror from acquiring interests in the shares of the offeree company, and for restricting shareholders from selling their shares in the offeree company to the offeror, once the first closing date has passed.

2.12 In addition, the Code Committee notes that the restriction on a unilateral offeror acquiring interests in shares above the thresholds described in Rule 5.1 prior to receiving merger clearance is not an absolute restriction and that a unilateral offeror's offer might still succeed before merger clearance in relation to the offer is obtained, notwithstanding the terms of Rule 5.2(c)(iii). This is because the offeror might be able to take advantage of another of the exceptions provided in Rule 5.2 (for example, one of the exceptions provided in Rules 5.2(a), 5.2(c)(ii) and 5.2(c)(iii)(2)) in order to acquire such number of shares as to enable the "50%" acceptance condition stipulated in Rule 9.3 to be satisfied.

2.13 The Code Committee also notes that Rule 5.1 restricts acquisitions by a unilateral offeror only, and that the restrictions do not apply where the board of the offeree company has publicly recommended an offeror's offer or has consented to an acquisition that would otherwise be restricted (Rules 5.2(b) and 5.2(c)(i)).

However, there might nevertheless be a similar degree of uncertainty as to whether a recommended offer will be the subject of a phase II investigation by the UK or EC competition authorities in such circumstances. That said, the board of the offeree company would presumably have taken the likelihood of the offer receiving merger clearance into consideration as part of its determination whether to recommend the offer or consent to the acquisition.

2.14 In view of the above, the Code Committee believes that there should be a partial liberalisation of Rule 5.2(c)(iii), such that, in all cases, an offeror should be free to acquire interests in shares of the offeree company following the first closing date of its offer or of any competing offer (irrespective of whether it has been clarified whether the offer will be the subject of a phase II investigation by the Competition Commission or the European Commission).

2.15 The Code Committee acknowledges that it might be argued that it is possible for a unilateral offeror to arrange its affairs in such a way as to ensure that it is able to acquire interests in shares through the thresholds described in Rule 5.1 shortly after the passing of the first closing date. For example, since the OFT must (absent a timetable extension) announce its decision whether or not to refer an offer to the Competition Commission within 20 working days of being notified of the proposed merger, an offeror which filed its notification with the OFT five or more working days prior to the publication of its offer document might expect to have received clearance by not later than the first closing date. However, the Code Committee does not consider this to be a compelling argument. In particular, the Code Committee notes that there is no mandatory requirement to notify mergers to the OFT and that reliance on this argument might force offerors to incur the costs and administrative burdens of making a notification which, but for the provisions of Rule 5.2(c)(iii), they would not otherwise make (see below).

2.16 Notwithstanding that, in certain cases, a unilateral offeror might be able to arrange its affairs in order to generate a decision from the OFT prior to the first closing

date of its offer, the Code Committee notes that there may be cases where this is not possible, such that uncertainty as to whether a unilateral offer will be referred to the Competition Commission, or whether the European Commission will be undertaking a phase II investigation, might persist beyond the first closing date. For example, an offeror may wish to announce its offer and publish its offer document on the same day or the OFT may exercise its discretion to extend the period for considering a merger notice by up to ten working days. In such circumstances, the Code Committee does not believe that shareholders in the offeree company would be disadvantaged by any potential market uncertainty that might then exist, given that the board of the offeree company will have had adequate opportunity to explain this to shareholders, and advise them accordingly, in the period of time prior to the first closing date of the offer, and that shareholders should then be able to decide what action, if any, they wish to take in the light of that advice.

2.17 The Code Committee notes that it could be argued that the proposed liberalisation of Rule 5.2(c)(iii) could, in certain circumstances, exacerbate any adverse effects that might result for shareholders in the offeree company in the event that a unilateral offeror's offer is subjected to a competition reference. For example, an offeror might acquire a 29.9% shareholding prior to the first closing date and then make further acquisitions to 45% following the passing of the first closing date and prior to its offer being referred to the Competition Commission. Upon being referred, the offer would automatically lapse (in accordance with the term required to be included pursuant to Rule 12.1(a)) and, if the Competition Commission was subsequently to prohibit the merger and require the offeror to divest its shares in the offeree company in order that it was no longer able materially to influence the policy of the company[1], this might lead to a fall in the market price of the offeree company's shares. If this were to happen, it is arguable that a divestment from a starting level of 45% might have a greater impact on the offeree company's share price than a divestment from a starting

[1] See section 26 of the Enterprise Act 2002.

level of 29.9%. However, the Code Committee questions whether the impact would, in reality, be materially greater. In addition, as mentioned above, this scenario could equally occur today if a unilateral offeror were able to take advantage of another of the exceptions in Rule 5.2, or in the case of a recommended offeror.

(d) Where an offer does not come within the statutory provisions for possible reference

2.18 As indicated above, under Rule 5.2(c)(iii), the restrictions in Rule 5.1 do not apply to an offeror where, amongst other things:

(a) the first closing date of its offer has passed and the offer does not come within the statutory terms for possible reference to the Competition Commission or within the scope of the EC Merger Regulation; or

(b) the first closing date of a competing offeror's offer has passed and that offer does not come within the statutory terms for possible reference to the Competition Commission or within the scope of the EC Merger Regulation.

2.19 Under the Enterprise Act 2002 (the "**Act**"), the OFT may make a reference to the Competition Commission if the OFT believes that it is, or may be, the case that a relevant merger situation has been, or will be, created and the creation of that situation has resulted in, or will result in, a substantial lessening of competition within any market or markets in the UK for goods or services.

2.20 Broadly, a relevant merger situation will have been, or will be, created (and the OFT and the Competition Commission will therefore have jurisdiction to review the merger) if two or more enterprises cease to be distinct enterprises and either:

(a) the turnover in the UK of the enterprise being taken over exceeds £70 million (the "turnover test"); or

(b) the enterprises together account for a share of supply of at least 25% of goods or services of a particular description in the UK or a substantial part of it (the "share of supply test").

2.21 The Code Committee understands that, whilst the turnover test may be assessed objectively, this is not the case for the share of supply test, in that, in describing the relevant goods or services to be considered for the purposes of the share of supply test, the OFT is given a wide discretion under the Act to take into account such criteria as it considers appropriate. In particular, the OFT is not limited to the parties' combined market share of a relevant market but may select any categorisation or segmentation of products or services as it sees fit. Therefore, a number of offers for offeree companies which do not meet the turnover test may potentially meet the share of supply test and, as such, fall within the statutory provisions for possible reference, even though there is no realistic prospect that the merger will be referred by the OFT to the Competition Commission.

2.22 As indicated above, regardless of whether the OFT would have jurisdiction to review it, there is no mandatory requirement to notify a merger to the OFT. The Code Committee therefore understands that, in cases where competition concerns clearly do not, or are highly unlikely to, arise (because there is no material overlap between the merging parties' activities), it may well be decided that notification to the OFT would be disproportionate and unnecessary. However, the Code Committee understands that it is possible to apply to the OFT for a decision that a transaction is not a relevant merger situation (a "found-not-to-qualify" or "FNTQ" decision).

2.23 Accordingly, unless it is able to avail itself of one of the other exceptions in Rule 5.2, a unilateral offeror whose offer could (technically) fall within the statutory

provisions for possible reference, but who has decided not to make a notification to the OFT (because competition concerns clearly do not, or are highly unlikely to, arise) will not be able to acquire interests in shares through the thresholds described in Rule 5.1. This is because there will be no announcement that the offer is not to be referred to the Competition Commission (since the OFT will not have been notified of the merger). The Code Committee understands from the Panel Executive that this issue has arisen on a number of unilateral offers in recent years.

2.24 In addition, owing to the OFT's wide discretion to describe goods and services for the purposes of the share of supply test, the Code Committee understands that it is difficult in practice for an offeror to establish with certainty that its offer does not come within the statutory provisions for possible reference to the Competition Commission. In order to be able to take advantage of this particular exception in Rule 5.2(c)(iii), an offeror would be required either (i) to procure a found-not-to-qualify decision from the OFT or (ii) to provide confirmation from its competition lawyers that the offer did not come within the statutory provisions for possible reference and (in the latter case) for the offeree company and any competing offerors to accept that this was so. This is because it is not possible for the Panel to adjudge whether or not a matter falls within the jurisdiction of another regulatory body and, therefore, a derogation will not normally be granted from provisions which turn on such issues without the consent of all of the other parties to an offer. However, there is, of course, a risk that, even where an offeror's competition lawyers have confirmed that the offer falls outside the OFT's jurisdiction, another party to the offer will, as a tactical matter, dispute this in an attempt to deny the offeror the advantage that would result from its acquiring further interests in shares.

2.25 Accordingly, the exception in Rule 5.2(c)(iii) for offers which do not come within the statutory provisions for possible reference is, in effect, redundant. As a consequence, a unilateral offeror which wishes to acquire interests in shares

through the thresholds described in Rule 5.1, but which is unable to avail itself of any of the other exceptions in Rule 5.2, is, in effect, forced to file a merger notice with the OFT in order to generate an announcement by the OFT that the offer is not to be referred to the Competition Commission. The Code Committee believes that it is disproportionate and unnecessary for the costs and administrative burdens of filing a merger notice to be imposed on an offeror in circumstances in which it would not otherwise do so and that Rule 5.2(c)(iii) should therefore be amended.

(e) Proposed amendment

2.26 In the light of the above, the Code Committee proposes to amend Rule 5.2(c)(iii) as follows:

"**5.2 EXCEPTIONS TO RESTRICTIONS**

The restrictions in Rule 5.1 do not apply to an acquisition of an interest in shares carrying voting rights in a company by a person:—

…

(c) after the person has announced a firm intention to make an offer provided that, at the time of the acquisition, there is no pre-condition to which the making of an offer is subject and:

…

(iii) ~~either:~~

~~(1)~~ the first closing date of that offer or of any competing offer has passed ~~and it has been announced that such offer is not to be referred to the Competition Commission (or such offer does not come within the statutory provisions for possible reference) and it has been established that no action by the European Commission will any longer be taken in respect of such offer pursuant to Council Regulation 139/2004/EC (or such offer does not come within the scope of such Regulation); or~~

~~**(2) the first closing date of any competing offer has passed and it has been announced that such competing offer is not to be referred to the Competition Commission (or such competing offer does not come within the statutory provisions for possible reference) and it has been established that no action by the European Commission will any longer be taken in respect of such offer pursuant to Council Regulation 139/2004/EC (or such offer does not come within the scope of such Regulation);**~~ **or**".

Q.1 Do you agree that Rule 5.2(c)(iii) should be amended as proposed?

(f) General review of Rule 5

2.27 The Code Committee is proposing, in due course, to undertake a more general review of Rule 5 in order to establish whether there might be a case for further amending, or deleting, certain (or even all) of provisions of the Rule. Although this is expressly not the subject of the present consultation, the Code Committee would welcome any views on these issues ahead of commencing its general review.

3. Assessment of the impact of the proposals

3.1 The Code Committee believes that, at present, the provisions of Rule 5.2(c)(iii) are unduly restrictive and, in certain respects, redundant. The Code Committee believes that, in certain circumstances, the effect of Rule 5.2(c)(iii) is to impose on offerors the costs and administrative burdens associated with filing merger notices in circumstances in which they would not otherwise do so and that these costs and burdens are disproportionate and unnecessary.

3.2 The Code Committee believes that the proposed liberalisation of Rule 5.2(c)(iii):

(a) would be a proportionate response to the problems identified;

(b) would not result in material costs being incurred by parties to offers or other market participants; and

(c) would, in certain circumstances, result in cost savings for offerors who would no longer be required to file unnecessary merger notices with the OFT.