

**PCP 2012/1 - Response of the Takeovers Joint Working Party of the City of London Law Society Company Law Sub-Committee and the Law Society of England and Wales' Standing Committee on Company Law**

**Introduction**

The Law Society of England and Wales is the representative body for solicitors in England and Wales. The City of London Law Society represents the professional interests of solicitors in the City of London who represent 15 per cent. of the profession in England and Wales.

Below are the views of the Takeovers Joint Working Party of the City of London Law Society Company Law Sub-Committee and the Law Society of England and Wales' Standing Committee on Company Law (the "Working Party") on the Panel Consultation Paper PCP 2012/1.

**General Comments**

1. We welcome and support the Code Committee's stated aims of seeking to: apply more proportionate requirements than at present to certain profit forecasts; adopt a more logical framework than the current Rule 28; and achieve greater consistency with other standards and guidance (notably the approach of the UKLA in its application of the Listing Rules and ESMA guidance) in the area of profit forecasts.
2. We are also pleased to note that a number of the views and comments made in our previous response on PCP 2010/1 have been reflected in the proposed amendments set out in this PCP.
3. In particular, we are supportive of the Code Committee's conclusion that Rule 28 should be amended to allow for a more proportionate regime in certain circumstances, requiring confirmations by the directors of the continued validity of the profit forecast together with a statement of the assumptions (as set out in new Rule 28.1(c)), without requiring reports from accountants or financial advisers.
4. However, we do not agree with the Code Committee's conclusions that (i) ordinary course profit forecasts should only fall within the more proportionate regime if the other parties to the offer give their consent; or (ii) the moment of the approach, or the moment of first active consideration in the case of a forecast published by a non-cash offeror, should be taken as the moment at which the full requirements of Rule 28 (i.e. requiring reports) should apply to profit forecasts. Instead, we suggest that the commencement of the offer period is the more logical moment at which the full requirements of Rule 28 should apply i.e. if an offeree publishes a profit forecast after an approach but prior to the commencement of an offer period, it should be required to repeat it and include confirmations by the directors but not be required to include reports.
5. In particular, we note that the majority of announcements of a firm intention to make an offer are made without any prior leak or announcement, on a recommended basis. Many of those transactions involve many weeks and even months of preparation. To apply the full requirements of Rule 28 and require reports in relation to any profit forecast made throughout that potentially long period between the approach and the commencement of the offer period does not seem to us to be a proportionate means of ensuring that such statements have been prepared to an appropriate standard. This seems to us to be disproportionately onerous and costly and might deter companies from making ordinary course profit forecasts.
6. In addition, in the case of an offeree company which has received an unsolicited and unwelcome approach but which chooses not to name the potential offeror preferring instead to

see-off the unwelcome potential offeror in private, to apply the full requirements of Rule 28 throughout the period between the approach and the withdrawal of the potential offeror (either through "downing tools" or withdrawing its interest), does not seem to us to be a proportionate means of ensuring that such statements have been prepared to an appropriate standard. Instead, we suggest that requiring confirmations by the directors of the continued validity of the profit forecast together with a statement of the assumptions (as set out in new Rule 28.1(c)), would be a proportionate means of doing so, in relation to profit forecasts made in the period between the approach and the commencement of the offer period.

7. We consider that to apply the full rigour of Rule 28 to a potential securities offeror from the moment of first active consideration would be even more disproportionate. The risk of a potential securities offeror deliberately making a misleading profit forecast prior to approaching the offeree company is more remote and the Panel must take into account other legal constraints that would prohibit such behaviour (such as directors' duties and market abuse). In any event such a forecast would be caught by new Rule 28.1(c).
8. We also believe there to be an inconsistency within the new Rule 28 in relation to referring to the moment of the approach or the commencement of the offer period. New Rule 28.2, addressing the requirement to publish profit forecasts for intervening periods, only applies to statements for future financial periods published during an offer period (in our view, correctly), whereas new Rule 28.1(c) applies from the moment of approach or first active consideration, as the case may be.
9. If the Code Committee is not persuaded by the above an alternative approach could be to require reports if a profit forecast is published (i) after an approach and (ii) within a month of the commencement of the offer period.

## **Responses to the specific questions raised in the PCP**

### **Q1 Do you have any comments on the proposed new definitions of "profit forecast", "profit estimate" and "quantified financial benefits statement" and the proposed amendments of the definitions of "cash offeror" and "offer period"?**

We welcome and support the Code Committee's conclusion that new Rule 28 should be made more consistent with other rules and guidance in relation to profit forecasts and the proposal to include definitions of terms which are consistent with the definitions of those terms included in the PD Regulation and the FSA Handbook. However, we question why the Code Committee has proposed new definitions of "profit forecast" and "profit estimate" which are very close to but are not identical to the definitions of those terms included in the PD Regulation and the FSA Handbook. We are concerned that in the future persons may seek to exploit any such differences.

What is the reason behind the reference to "for a particular period" in the definition of profit forecast instead of "for the current financial period and/or financial periods subsequent to that period"? We note that the latter only covers profit forecasts that remain outstanding and appears to us to be preferable.

What is the reason behind the reference to "audited results" in the definition of profit estimate instead of "results"? We note that the exemptions set out in new Rule 28.4 include unaudited results.

It is not clear how the definition of "cash offeror" will be applied (or new Rule 28) where an offeror initially offers cash, and so falls within the definition, at the outset but then adds a share alternative (either between the approach and the offer, or by adding a securities

alternative during an offer). At that point it would appear to be brought back into the profit forecast regime but it is not clear how that will apply in practice, or whether it would be proportionate to do so.

We also suggest moving the definition of "ordinary course profit forecast" from new Note 2 on Rule 28.1 into the definitions section.

**Q2 Do you agree that the requirements for assumptions to be stated and for third party reports to be obtained should be retained for profit forecasts and quantified financial benefits statements which are first published during an offer period? Do you have any comments on the proposed new Rule 28.1(a)?**

We refer to our general comments above.

**Q3 Do you agree that the requirements for assumptions to be stated and for third party reports to be obtained should be retained for profit forecasts which have been published following the making of an approach or, in appropriate circumstances, the first active consideration of a possible offer? Do you have any comments on the proposed new Rule 28.1(b) and Note 1 on Rule 28.1?**

We refer to our general comments above.

In addition, the new Note 1 on Rule 28.1 states that "the Panel may apply Rule 28.1(b)" to a profit forecast published by an offeror prior to the commencement of an offer period and prior to an approach but following first active consideration of an offer. This leaves a good deal of uncertainty as to whether it is a requirement or not. (This could be contrasted with the more usual approaches of either applying a requirement leaving the ability for the Executive to grant a dispensation, or requiring the relevant party to consult the Executive to determine whether or not the requirement applies in a particular case.)

More importantly, even if the Code Committee is not persuaded by the general comments made above and the Code Committee retains the references to the moment of the approach throughout new Rule 28.1, we suggest that the new Note 1 be deleted. While the Executive does make judgements in relation to first active consideration for the purposes of Rule 2 it is relevant and proportionate to do so in that context. Many companies, both domestic and overseas, regularly consider acquisitions and might well be inclined to speak to professional advisers, at a highly preliminary stage before even considering making an approach. For all such companies to be subject to new Rule 28.1 in those circumstances, in order to guard against the remote risk of a securities offeror deliberately publishing a profit forecast prior to making an approach simply to avoid producing an accountants report and thereby deliberately seek to influence offeree company shareholders, seems disproportionately onerous and costly. In any event, such a forecast would be caught by new Rule 28.1(c).

If the Code Committee is not persuaded to delete new Note 1 on Rule 28.1, then it should be amended to expressly carve out a cash offeror and amended to make clear that Rule 28.1(c) would not apply (because as currently drafted new Note 1 and Rule 28.1(c) would both appear to apply).

**Q4 Do you agree with the proposed new requirements with regard to an outstanding profit forecast? Do you have any comments on the proposed new Rule 28.1(c)?**

We refer to our general comments above.

We note Rule 28.1(c)(i) on page 109 refers to "a confirmations" whereas page 27 refers to "confirmations" and new Notes 2 and 3 on Rule 28.1 refer to "a confirmation".

**Q5 Do you agree with the proposed ability for the Panel to grant a dispensation from the proposed new Rules 28.1(a) and (b) in relation to ordinary course profit forecasts? Do you have any comments on the proposed new Note 2 on Rule 28.1?**

We welcome and support the proposed ability for the Panel to grant a dispensation in relation to ordinary course profit forecasts and are pleased that the Code Committee has moved away from the requirement proposed in PCP 2010/1 that such a profit forecast would have to have been made within one month prior to the commencement of the offer period to qualify for such a dispensation.

However, we believe that the proposed requirement to obtain the consent of all the parties to an offer is not appropriate. We believe that it is the Panel's role to regulate this area and that role should not be delegated to the parties to an offer. Such a requirement would give a significant advantage to offerors and would run contrary to the theme of the consultations of 2010 following Kraft's bid for Cadbury. We believe that such a requirement would allow parties to an offer to make mischief and bargain with their consent. We believe that such a requirement will cause problems in hostile and competing bids, particularly if consent is obtained but a competing bidder subsequently emerges who raises an objection. In addition, we do not believe that an unnamed white knight is caught by the definition of party to an offer whereas a named white knight would be, which seems to be an inconsistency in this context (but would not suggest amending the definition where the distinction is relevant in other contexts).

Accordingly, we believe that the Panel should determine whether a dispensation should be granted and further believe that the requirements of new Note 2 (ie the requirements of new Rule 28.1(c) as applied to repeated profit forecasts) are sufficient and proportionate to be applied in the context of all "ordinary course" profit forecasts without the need for any party's consent or any other additional requirements.

We note that if the Panel accepts the suggestion in the general comments above the issues around "ordinary course" forecasts would be addressed in that way i.e. profit forecasts made prior to the commencement of an offer period would be repeated and confirmations given. A non-ordinary course profit forecast which was problematic would not be capable of being repeated in this way and the directors would need to state that it was no longer valid.

**Q6 Do you agree with the proposal for the Panel to be able to grant a dispensation from the proposed new Rules 28.1(a) and (b) in relation to profit forecasts for certain future financial periods? Do you have any comments on the proposed new Note 3 on Rule 28.1?**

We welcome and support the proposal.

**Q7 Do you agree with the proposed requirement to publish corresponding profit forecasts for the current and intervening financial periods where a profit forecast**

**for a future financial period is published? Do you have any comments on the proposed new Rule 28.2?**

We agree with the proposed requirement in relation to forecasts for future financial periods looking forward two or three financial years. However, we feel that there should be a distinction between profit forecasts for future periods and long term targets. In our view, statements or forecasts looking forward four or five financial years would be given considerably less weight and would be regarded by shareholders and potential investors as nothing more than targets. We believe that anything which, in its context, is a target and which contains appropriate caveats should be treated as a target rather than a profit forecast.

New Rule 28.2 should include an express cross reference to the exemption available in new Note 3 on Rule 28.1 and referred to in paragraph 6.11 of PCP 2012/1. Alternatively, new Rule 28.2 should have a new Note added explaining the exemptions referred to in paragraph 6.11 of PCP 2012/1.

**Q8 Do you agree that reports should always be required to be obtained on a profit forecast where the offer is a management buy-out or is made by the existing controller of the offeree company? Do you have any comments on the proposed new Note 4 on Rule 28.1?**

We recognise the Code Committee's concern as described in paragraph 7.1 of the PCP.

However, we do not agree that reports should "always" be required to be obtained. We note there is no definition of an MBO. We are concerned to distinguish between an MBO led by the incumbent management in which they have sought and found financial backers (debt or equity or a mixture of both) and a leveraged bidder which after its approach might well be interested in retaining some or all of the incumbent management. In the latter case, the risk of the concern described in paragraph 7.1 of the PCP is no different from any bid where certain of the offeree company directors will be retained. To put it another way, we suggest that it is not proportionate to address the concern identified for new Rule 28.1(a) to apply in full whenever there is a single director which has a conflict of interest under Note 5 on Rule 25.2. Instead the Executive should consider the context, including the time of the forecast, time of the approach, whether the board was split (in order to exclude the conflicted executives) and the conflicted directors excluded from board decisions, including publishing forecasts. The role of the independent non-executive directors is very important in such circumstances and should provide a good deal of protection against the risk identified by the Code Committee in the context of an MBO.

We suggest that new Note 4 on Rule 25.2 be drafted as a requirement for parties to consult with the Panel in the case of an MBO or similar transaction (and suggest following the approach taken in relation to whitewashes in new Note 5 on Rule 28.1).

In addition, we suggest amending new Note 4 to make clear that the dispensation available under new Note 3 will continue to be available in cases to which Note 4 applies (see Appendix A to PCP 2012/1).

**Q9 Do you have any comments on the proposed new Note 5 on Rule 28.1 with regard to profit ceilings?**

Subject to the comments made above in relation to management buy-outs or similar transactions (which would apply equally to new Note 5 on Rule 28.1), we agree with the proposed new Note 5 on Rule 28.1

**Q10 Do you agree that the Code should expressly provide the Panel with the ability to grant a dispensation from the requirements of Rule 28 where the offer would not result in a material increase in the equity share capital of the offeror? Do you have any comments on the proposed new Note 6 on Rule 28.1?**

We agree with the proposed approach and suggest that it would be helpful for the guidance given in paragraph 9.5 of the PCP to be included in new Note 6 on Rule 28.1.

In addition, we suggest the following amendments for clarity:

"In the case of a securities exchange offer, the Panel may grant a dispensation from the requirements of Rule 28 for profit forecasts and quantified financial benefits statements published by an offeror, if ..."

**Q11 Do you have any comments on the proposed new Note 7 on Rule 28.1 in relation to the compilation of profit forecasts and quantified financial benefits statements?**

We welcome and support the proposed alignment of the Code's requirements with the guidance set out in the ESMA recommendations.

**Q12 Do you have any comments on the proposed new Rule 28.3 with regard to assumptions in relation to profit forecasts and quantified financial benefits statements?**

No.

**Q13 Do you agree that the exemption from the requirements of Rule 28 for certain profit estimates should be extended as proposed? Do you have any comments on the proposed new Rule 28.4?**

We agree that the exemption should be extended.

Is the Code Committee able to give further guidance as to which regulatory requirements might allow the Panel to grant the dispensation referred to in Rule 28.4(b)? For example, will the requirements of EU regulated markets suffice for these purposes?

In relation to the new Note on Rule 28.4, how will the Panel be satisfied? We do not believe this is described in the Note or in the PCP. Can the Code Committee give further guidance on this aspect?

**Q14 Do you have any comments on the proposed new Rule 28.5 in relation to quantified financial benefits statements?**

We refer to our general comments above regarding referring to the commencement of the offer period rather than the approach, which is relevant to new Note 1 on Rule 28.5.

We consider the concept of quantified financial benefits to be preferable to quantified financial effects as described in PCP 2010/1 and agree with the proposed approach of consistency between profit forecasts and such statements.

The heading on new Note 2 still refers to "merger benefit statements" and should be amended.

**Q15 Do you have any comments on the proposed new Rule 28.6 with regard to a profit forecast for part of a business?**

We refer back to the comments made in our previous response to PCP 2010/1 regarding the importance of including a concept of materiality. We do not agree that "the Panel's starting point would be likely to be that, if a company had chosen to publish a profit forecast in relation to a particular part of its business, that forecast would be likely to be material, such that the requirements of Rule 28 should apply" as stated in paragraph 14.3 of the PCP. There might be any number of reasons for doing so unconnected with the offer, for example a business which has distinct divisions or businesses might choose to give visibility on performance within each business as part of its normal course of communication with its shareholders. That level of detail might well not be material in the context of the offer.

**Q16 Do you have any comments on the proposed new Rule 28.7(a), the proposed amendments to Note 5 on Rule 19.1, or the proposed Note 1 on Rule 28.7, with regard to references by a party to an offer to third party or average forecasts with respect to its own profits?**

We agree that this is an application of Note 5 on Rule 19.1 and agree with the codification of the Executive's existing practice. We support the proposed "right of reply".

We suggest that the removal of consensus forecasts from a party's website also be specifically referred to if this is the Code Committee's intention. However, we suggest that this would be an onerous and disproportionate requirement.

**Q17 Do you have any comments on the proposed new Rules 28.7(b) and (c), and the proposed new Notes 2 to 4 on Rule 28.7, with regard to a party to an offer referring to consensus profit forecasts with respect to the profits of another party to the offer?**

We suggest deleting "Where an offer has been, or will be, recommended by the board of the offeree company, or" at the start of new Note 3 on Rule 28.7. Requiring the party making the reference to the consensus to state whether or not it is doing so with the agreement or approval of the party to whom the consensus relates and if it is then applying new Rule 28.7(a) is sufficient. The reference to offers which "will be" recommended is uncertain and difficult to judge.

We note that as currently drafted new Rule 28.7(b) and new Rule 28.7(c) appear to indicate that the use of a consensus forecast would be possible in a recommended offer, which is wider than paragraphs 15.9 and following of PCP 2012/1, which suggest that consensus forecasts can only be used in hostile offers.

In new Note 4(a)(ii) on Rule 28.7 the reference to “consensus figure” might be clearer if changed to refer to “average profit figure”.

**Q18 Do you have any comments on the proposed new Rules 27.1 and 27.2(a)(i) with regard to material changes in information?**

We welcome and support the proposed approach. We believe that the obligation to announce material changes should extend to any material change in circumstances, not just changes to information previously disclosed. We would suggest a disclosure obligation similar to that found in DTR2 of the Disclosure Rules and Transparency Rules, which will of course apply to many offerees in any event. AIM Rule 11 is very similar to DTR2 and PLUS has a very similar rule.

**Q19 Do you have any comments on the proposed new Rules 27.2(a)(ii), 27.2(b) and 27.2(c) in relation to the requirement to update certain matters in any subsequent document?**

No.

**Q20 Do you have any further comments on the proposed new Rule 27 and the related Code amendments?**

In new Rule 27.2(d), should the Code provide some guidance on what a party should do if its directors are not able to provide the required confirmations, for example as set out in Rule 28.1(c)(ii) – (iii)?

**Q21 Do you have any comments on the proposed amendments relating to the current Rule 28.4?**

No.

**Q22 Do you have any comments on the proposed amendments to Rule 26 in relation to documents on display?**

We note that references to "on display" have been updated to refer to publication on a website. We note that certain references to display remain though in the headings to Rules 26.1 and 26.2 and Note 5 on Rule 26.

In Rule 26.2(f)(ii), we believe this should say "the inclusion of its opinion on value" and not "of" value as currently drafted.