

PCP 15 Issued on 21 July 2003

THE PANEL ON TAKEOVERS AND MERGERS

**CONSULTATION PAPER ISSUED BY
THE CODE COMMITTEE OF THE PANEL**

OFFEREE PROTECTION CONDITIONS

**REVISION PROPOSALS RELATING TO
RULE 13 OF THE TAKEOVER CODE**

Before it introduces or amends any Rules of the Takeover Code (“the Code”) or the Rules Governing the Substantial Acquisitions of Shares (“the SARs”), the Code Committee of the Takeover Panel is normally required under its consultation procedures 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 Consultation Paper. Comments should reach the Code Committee by 1 September 2003.

Comments may be sent by email to:

consultation@disclosure.org.uk

Alternatively, please send comments in writing to:

The Secretary to the Code Committee
The Panel on Takeovers and Mergers
P.O. Box No. 226
The Stock Exchange Building
London
EC2P 2JX

Telephone: 020 7382 9026

Fax: 020 7638 1554

It is the Code Committee’s policy to make all responses to formal consultation available for public inspection unless the respondent requests otherwise.

1. Introduction

- 1.1 The Code Committee is aware of a number of recent offers where conditions to the offer have been included for the benefit of shareholders in the offeree company rather than, as is normally the case, for the benefit of the offeror. Such conditions are referred to in this paper as “offeree protection conditions”.
- 1.2 Offeree protection conditions are only relevant in recommended transactions and they are generally only found in the context of securities exchange offers where the board of the offeree company wishes to ensure that the consideration securities received by the offeree company’s shareholders have a value which is not materially different from that contemplated by the board at the time that it gave its recommendation. Clearly such concerns do not arise in the context of a cash offer.
- 1.3 Whether or not an offeror is willing to agree to the inclusion of offeree protection conditions will always be a matter for negotiation between the parties. However, offeree protection conditions are increasingly a feature of bids where the offeror and the offeree company are of similar sizes and in such cases the parties often agree to reciprocal conditions.
- 1.4 The structure of offeree protection conditions has depended upon whether the transaction is to be implemented by means of an offer or a scheme of arrangement. In general, the position is as follows:
 - (a) offer: all the waivable conditions to the offer, including the offeree protection conditions, are waivable by the offeror save that conditions which are exclusively for the benefit of the offeree can only be waived by the offeror at the direction of the offeree, and conditions which are for the benefit of both the offeror and the offeree may only be waived by the offeror with the consent of the offeree;
 - (b) scheme of arrangement: in addition to certain non waivable conditions relating to, for example, shareholder approvals, court approval and

admission of the consideration securities to trading, the scheme is subject to similar commercial conditions as are found in the context of a conventional offer. These commercial conditions, including the offeree protection conditions, may be waived by the party for whose benefit the condition has been included or, where the condition is included for both parties' benefit, it may be waived by both the offeror and the offeree acting together.

- 1.5 The Code Committee understands the commercial rationale behind offeree protection conditions and considers that it is entirely legitimate for boards of offeree companies to seek a measure of protection for the company's shareholders in this manner. Absent the ability to include offeree protection conditions, the only means available to the board of an offeree company to safeguard the interests of the company's shareholders in the event that the board ceases to believe that the offer is in their best interests is for the board to recommend shareholders not to accept the offer and, in the event that withdrawal rights are running, to withdraw any acceptances which have already been delivered. However, such action might be of limited effect if the event which causes the board of the offeree company to change its recommendation occurs late in the offer period by which stage the offeror may already have received sufficient acceptances to be capable of declaring its offer unconditional as to acceptances (and once the offer is declared unconditional as to acceptances, withdrawal rights cease to run).

2. Relevant provisions of the Code

- 2.1 Rule 13 and the Notes on Rule 13 provide as follows:

“RULE 13. SUBJECTIVE CONDITIONS

An offer must not normally be subject to conditions which depend solely on subjective judgements by the directors of the offeror or the fulfilment of which is in their hands.

NOTES ON RULE 13

1. *An element of subjectivity*

The Panel may be prepared to accept an element of subjectivity in certain special circumstances where it is not practicable to specify all the factors on which satisfaction of a particular condition may depend, especially in cases involving official authorisations, the granting of which may be subject to additional material obligations for the offeror. It would also normally be acceptable in an announcement for an offer to be expressed as being conditional on statements or estimates being appropriately verified.

2. *Invoking conditions*

An offeror should not invoke any condition so as to cause the offer to lapse unless the circumstances which give rise to the right to invoke the condition are of material significance to the offeror in the context of the offer. The acceptance condition, and any condition included pursuant to Rule 12.1(c), are not subject to this provision.”

- 2.2 Accordingly, on the basis that Rule 13 and the Notes on Rule 13 are framed so as to apply only to conditions included for the benefit of an offeror, these provisions do not apply to offeree protection conditions. As a result, it is not clear on the face of the Code whether offeree protection conditions can be framed in subjective terms and whether the test for their invocation is by reference to the test set out in Note 2 on Rule 13 or by reference to another test. Although these issues have not attracted much scrutiny to date as there have not yet been any cases where an offeree company has sought to invoke an offeree protection condition, the Code Committee believes that the Code should make clear the circumstances in which such invocation will be permissible.

3. Arguments in favour and against amending Rule 13 and the Notes on Rule 13 to apply to offeree protection conditions

In favour

3.1 The Code Committee considers that the arguments in favour of amending Rule 13 to apply to offeree protection conditions, and in favour of adopting the same test for their invocation as that set out in Note 2 on Rule 13, are as follows:

- (a) it is unsatisfactory for the Panel to have a clearly determined role in the supervision and invocation of conditions by an offeror but for this not to be clearly spelt out in respect of offeree protection conditions. It is undesirable for there to be uncertainty on such a key aspect of takeover regulation as the circumstances in which an offer may be withdrawn or lapsed and this runs contrary to the requirement set out in the Introduction to the Code that offers to which the Code applies should be conducted in an orderly framework;
- (b) one of the purposes of Rule 13 is to avoid the creation of false markets in the securities of an offeror or the offeree company by preventing an offeror from withdrawing or lapsing an offer except in appropriate circumstances. This principle applies equally in respect of the invocation of offeree protection conditions; and
- (c) it is logical and sensible that the test for whether an offeree protection condition can be invoked should be the same as the test for whether an offeror can invoke a condition to an offer included for its benefit. This is particularly the case given that offeree protection conditions are usually found in transactions where the offeror and the offeree company are of similar sizes (such that the identity of the offeror and the offeree company could easily be reversed).

Against

- 3.2 Set against this, the Code Committee acknowledges that the safeguards set out in Rule 13 provide protection to offeree shareholders by ensuring that an offeror is not able to withdraw or lapse an offer on a whim and it is arguable that offeree shareholders' interests would best be served by having a lower threshold for the invocation of offeree protection conditions than that set out in Note 2 on Rule 13. This is because a lower threshold would provide offeree companies with greater flexibility than offerors in invoking offer conditions.
- 3.3 Having considered these arguments, the Code Committee is of the view that the Code should be amended so as to make Rule 13 and the Notes on Rule 13 apply equally to offeree protection conditions.

4. Proposed Code amendments

- 4.1 The Code Committee is proposing that Rule 13 and the Notes on Rule 13 should be amended as set out below:

“RULE 13. SUBJECTIVE CONDITIONS

An offer must not normally be subject to conditions which depend solely on subjective judgements by the directors of the offeror or the offeree company (as the case may be) or the fulfilment of which is in their hands.

NOTES ON RULE 13

1. An element of subjectivity

The Panel may be prepared to accept an element of subjectivity in certain special circumstances where it is not practicable to specify all the factors on which satisfaction of a particular condition may depend, especially in cases involving official authorisations, the granting of which may be subject to additional material obligations for the offeror or the offeree company (as the

case may be). It would also normally be acceptable in an announcement for an offer to be expressed as being conditional on statements or estimates being appropriately verified.

2. *Invoking conditions*

An offeror or an offeree company should not invoke any condition so as to cause the offer to lapse unless the circumstances which give rise to the right to invoke the condition are of material significance to it in the context of the offer. The acceptance condition, and any condition included pursuant to Rule 12.1(c), are not subject to this provision.”

- 4.2 The Code Committee considers that, if the proposed amendments are adopted, the application of Note 2 on Rule 13 to offeree protection conditions will be the same as the application of that provision to offeror conditions.

Q Do you agree with the changes proposed to made to Rule 13 and to the Notes on Rule 13?

5. **Cost/benefit analysis**

- 5.1 The Code Committee believes that these proposals will provide clarity on an important aspect of takeover regulation and, as such, will be of benefit to the parties to an offer and to the market generally. The Code Committee does not believe that these proposals will result in any significant increase in costs for either offerors or offeree companies.