



**PCP 9 Issued on 14 March 2002**

**THE PANEL ON TAKEOVERS AND MERGERS**

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

**QUESTIONS AS TO THE POTENTIAL CONCERTEDNESS OF THE  
TRUSTEES  
OF AN EMPLOYEE BENEFIT TRUST WITH THE BOARD AND/OR  
A  
CONTROLLING SHAREHOLDER**

**REVISION PROPOSALS RELATING TO RULE 9.1 OF THE  
TAKEOVER CODE**

Before it introduces or amends any Rules of the Takeover Code or the Rules Governing the Substantial Acquisitions of Shares, the Code Committee of the Takeover Panel is 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 9 May 2002.

Comments may be sent by email to:

[consultation@disclosure.org.uk](mailto: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  
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It is the Code Committee's policy to make all responses to formal consultation available for public inspection unless the respondent requests otherwise.

## **EMPLOYEE BENEFIT TRUSTS**

### **1. Introduction**

- 1.1 The Panel has from time to time to consider questions as to the potential concertedness of the trustees of an Employee Benefit Trust ("EBT") and the directors of a company and also that of the trustees and a controlling shareholder. This consultation paper sets out the

approach which the Panel proposes to take to these questions and a corresponding amendment to the Code.

## **2. Background**

- 2.1 An EBT is a trust established by a company for the purpose of acquiring and holding shares in that company, which will then be available to satisfy awards of shares or options granted to employees under one or more share schemes operated by that company. The trust deed will set down the methods by which shares may be acquired: whether subscription for new shares or purchase of existing shares, on or off market. The acquisition of shares by the trustees will normally be funded by loans or grants made to the trust by the company. In order to distance the directors from individual purchases, the company may make a loan facility available to the trustees which they can draw down upon at times and in amounts determined by the trustees.
- 2.2 The satisfaction of awards through the transfer of existing shares rather than the issue of new shares is potentially beneficial to shareholders: in particular, through the avoidance of the dilution of earnings and control which may result from the issue of new shares.
- 2.3 The structures of employee share schemes vary considerably. Broadly speaking, there are two types of scheme: those which involve the gift of shares to employees in some form; and those which involve the purchase of shares by employees usually for market value (for example, through a share option scheme or restricted share scheme). Generally, shares will be allocated under such schemes by the trustees in their absolute discretion, although in practice the trustees will normally allocate shares in accordance with the recommendations of the company's remuneration committee (unless this would be contrary to or beyond their powers and duties). There is set out in Appendix A to this consultation paper, a description of various kinds of share scheme.
- 2.4 Despite this variation in structure of share schemes, a number of general observations can be made about holdings within EBTs. If shares are required for the purpose of satisfying existing awards, the trustees would not be able to assent them to an offer or sell them to an

offeror in the market. As a practical matter, even if the trustees hold shares beyond those required to satisfy existing awards, the trustees will rarely accept an offer before the offer has gone wholly unconditional. The voting rights attaching to shares held by the EBT will generally be exercisable by the trustees without reference to the directors or beneficiaries. Trustees will of course be bound by fiduciary duties and the terms of the constitutive trust deed to exercise their powers to promote the interests of beneficiaries. However, the trustees in most instances will follow recommendations of the board when voting at general meetings (or alternatively abstain).

2.5 A significant holding by an EBT may constitute a barrier to takeover, particularly as regards unsolicited bids, since the shares are generally unavailable to the bidder for the purposes of satisfying the acceptance condition. The possibility that an EBT may be deployed as a defensive measure is generally recognised.

2.6 In March 2001, the ABI issued consolidated guidelines for share incentive schemes operated by listed companies. Paragraph 22 of those guidelines stipulates that: EBTs should not hold more shares than would be required to match outstanding liabilities; EBTs should not be used as an anti-takeover or similar device; and the prior approval of shareholders should be sought where 5% or more of the company's share capital may be held within the EBT.

### **3. Potential concertedness of trustees and directors**

3.1 The question of potential concertedness of trustees and directors is generally only relevant in relation to the relatively small number of companies in which a controlling shareholding is collectively held by the directors, or by the board and the trustees taken together. The directors of a company will not generally be presumed to be acting in concert. A presumption of concertedness will, in general, only arise where the directors have reason to believe a bona fide offer for their company may be imminent (see paragraph (6) of the definition of "Acting in concert").

3.2 The argument is made that, since the directors are individually free to purchase shares even though, as a result, the aggregate holding of the

board will exceed 30%, it is illogical for the Panel to be concerned about purchases made by an EBT. The Code Committee does not, however, consider it correct to equate purchases by an EBT with individual purchases by directors (in respect of which there is no co-ordination by the board). The EBT is an arrangement made by a board with the trustees in respect of the acquisition of shares by the trustees utilising corporate funds. The board to a significant extent controls the size and timing of purchases by the trustees (since the Board funds the purchases and the Board, or its remuneration committee, makes share or option awards to which the purchases relate). In many instances, some or all of the trustees will be directors and the executive directors will normally be beneficiaries.

- 3.3 Because of those relationships, an argument can readily be made for treating the board and the trustees as acting in concert. The counter-argument is that the purpose of the acquisition of shares by the EBT is not to consolidate control of the company in the hands of the board but to facilitate the operation of share schemes designed to incentivise executives and other employees in the interests of shareholders in general. Discerning the real purpose of an acquisition can, however, be extremely difficult where a number of explanations present themselves (which is why the Code incorporates presumptions of concertedness where certain relationships exist).
- 3.4 The Panel has to weigh up the advantages to shareholders of the proper operation of an EBT in terms of the avoidance of dilution resulting from the issue of new shares against the potential for the use of an EBT as a means of consolidating control in the hands of directors and depriving shareholders of the prospect of an unsolicited bid.
- 3.5 The Code Committee believes that there are circumstances in which the trustees should be deemed to be acting in concert with the directors but does not propose that there should be a general presumption that directors and trustees are acting in concert. This would mean that the mere existence of an EBT would not result in the trustees and individual directors being precluded from buying shares if their aggregate holdings exceed 30%.

**Q1: Do you agree that there should not be a general presumption that**

## **the trustees and directors are acting in concert?**

### **4. Independence of trustees**

4,1 A significant issue is whether a presumption of concertedness should apply unless the trustees are independent of the board. A board, when establishing an EBT, will often be advised that the trustees should be independent (ie that a professional trustee should be appointed) in order to avoid the trustees being prevented from dealing during close periods and at other times when directors' dealings are prohibited. In practice, however, many companies (especially smaller ones) do not appoint professional trustees because of the expense. The argument against making the independence of trustees a conclusive factor is that the trustees can never truly act independently of the board since purchases are funded by the board and made in connection with awards made by the board (or its remuneration committee).

4.2 The limited extent of the independence of the trustees is an inherent feature of the overall arrangement and does not reflect on the professionalism of trustees. The Code Committee does not consider that the independence of trustees should be the conclusive factor in determining whether any presumption of concertedness should apply but instead believes that independence should be one of several relevant factors to be considered.

**Q2: Do you agree that the independence or otherwise of the trustees should not be a conclusive factor in determining whether the trustees should be deemed to be acting in concert with the board?**

### **5. Relevant factors**

5,1 The Code Committee believes that it is important that the Panel should be consulted in advance of any purchase by the trustees or a director which would result in the aggregate holdings of the board and the EBT reaching or increasing beyond 30%.

5.2 The Code Committee would not envisage that, after the initial consultation of the Panel, it would normally be necessary for the

advisers to a company to approach the Panel in advance of each individual purchase outside an offer period, where purchases are made on-market at the prevailing market price at times and levels consistent with the normal practice of the EBT.

- 5.3 The role of the Panel would not be to substitute its own views for those of the trustees as to the interests of beneficiaries, but to consider whether there were any unusual aspects to what was proposed, which would indicate that the proposed purchases were being made otherwise than principally for the purpose of facilitating an employee share scheme.
- 5.4 If the trustees were not independent of the board (in particular, where the directors constituted a majority of the trustees) and there was no independent remuneration committee, the Panel would scrutinise any proposed purchase more closely.

The factors which the Code Committee considers to be relevant include the following:

- (a) the identities of the trustees (in particular, whether any of the trustees are directors);
- (b) the composition of the remuneration committee (and in particular, whether the remuneration committee is constituted in accordance with the Combined Code);
- (c) the nature of the funding arrangements (for example, whether arrangements are in place such as a rolling credit facility which means that the trustees are in a position to purchase shares without requesting funds from the board ahead of each transaction);
- (d) the percentage of the share capital held by the EBT (and in particular, whether the 5% threshold set by the ABI in its guidelines

has been exceeded);

(e) the number of shares held to satisfy awards made to directors;

(f) the number of shares held compared with those required to satisfy existing awards to employees (and in particular, whether they are in excess of those required); and

(g) the price at which, the method by which and the persons from whom shares are to be acquired (and in particular, the reason for acquiring shares otherwise than on market at the prevailing market price).

**Q3: Do you consider that:**

(i) each of the factors listed in paragraph 5.5 above is relevant;

(ii) there are any other factors which should be considered?

5.6 If the trustees are deemed to be acting in concert with the board and their aggregate holdings amount to 30% or more, neither the trustees nor individual directors will be in a position to buy shares. It will, however, be possible for an issue of new shares to be whitewashed in accordance with the procedure laid down in Appendix 1 to the Code.

## **6. When the directors themselves are acting in concert**

6.1 The Code Committee proposes that the trustees should be deemed to be acting in concert with the directors if the directors themselves are presumed to be acting in concert, in particular, when the company is subject to an offer or if the board has reason to believe that a bid may be imminent.

**Q4: Do you agree that the trustees should be deemed to be acting in concert with the board when the directors themselves are deemed to be acting in concert?**

**7. Potential concertedness of trustees and controlling shareholder (or group)**

7.1 When a controlling shareholding (that is shares carrying 30% or more of the voting rights) is held by one person or a group acting in concert, for example a family, it is necessary to consider whether the trustees should be deemed to be acting in concert with the controlling shareholder (or that group).

7.2 One alternative would be to adopt substantially the same approach as that proposed above in relation to questions of concertedness between the trustees and the board: the Panel would not generally presume the trustees to be acting in concert with a controlling shareholder but would consider a number of relevant factors. However, the position of a controlling shareholder is different from that of the board since the controlling shareholder will not be in a position to increase his own holding (assuming he holds less than 50%). The EBT, if controlled by the controlling shareholder, could be used to make purchases which the controlling shareholder himself was not in a position to make without incurring an obligation to make a mandatory bid.

7.3 There is a strong argument that a presumption of concertedness should apply in such circumstances, irrespective of whether the controlling shareholder in fact has a representative on the board: by virtue of his controlling shareholding, the controller is often in a position to exert a dominant influence on the board. However, the Code Committee suggests that a more flexible approach should be taken: the trustees should only be presumed to be acting in concert with a controlling shareholder, if a controlling shareholder in fact exerts a dominant influence on the board. This would be taken to be the case if the majority of the directors, or any holder of a significant office (such as the Chairman, Chief Executive or Financial Director), are representatives of (or are otherwise closely connected with) the controlling shareholder. The directors closely connected with the

controlling shareholder will also be presumed to be acting in concert with the trustees; the position of other directors will depend upon the circumstances.

**Q5: Do you agree that the trustees should be presumed to be acting in concert with a controlling shareholder where the controlling shareholder in fact exerts a dominant influence on the board?**

## **8. Where beneficiaries control shares**

8.1 In the case of a few types of employee share scheme, the shares are retained in the EBT purely for tax reasons and the beneficiaries have effective control of the shares: the trustees are not able to dispose of the shares or exercise voting rights without instructions from the beneficiary and the beneficiary has the power to direct the trustees to sell the shares to an offeror or assent them to an offer. Where the trustees are presumed to be acting in concert with the directors and/or a controlling shareholder, the Code Committee would not propose that the presumption should apply in respect of shares controlled by the beneficiaries.

**Q6: Do you agree that any presumption of concertedness should not apply to shares held within the EBT but controlled by beneficiaries?**

## **9. Amendments to the Code and the SARs**

9.1 Amendments to the Code designed to give effect to the proposals in this paper are set out in Appendix B. Part A sets out a new Note 5 on Rule 9.1 which addresses the circumstances in which trustees will be deemed to be acting in concert with the directors or a controlling shareholder for the purposes of the Code. The Code Committee also proposes to introduce a new Note 5 on SAR 5 to make clear that where parties are considered to be acting in concert pursuant to the new Note 5 on Rule 9.1, they will also be considered to be acting by agreement or understanding for the purposes of SAR 5. This new Note is set out in Part B of Appendix B. As explained in paragraph 4.2 of PCP 10 on Shareholder Activism and Acting in Concert, which is being issued at the same time as this paper, the Code Committee

proposes to include a similar Note on SAR 5 in respect of the proposed amended Note 2 on Rule 9.1. If, following the consultation exercises, both Notes are considered appropriate, the Code Committee will amalgamate both these provisions into a single Note on SAR 5.

## **10. Cost Benefit/Analysis**

- 10.1 The Code Committee does not believe that these proposals will result in any additional costs to either companies or their shareholders.

## **APPENDIX A**

### **Types of scheme**

The structures of employee share schemes vary considerably. Broadly speaking, there are two types of scheme: those which involve the gift of shares to employees in some form; and those which involve the purchase of shares by employees usually for market value (for example, through a share option scheme or restricted share scheme).

### **The trustees' role**

Generally, shares will be allocated under such schemes by the trustees in their absolute discretion to directors and executives. Although the wishes of the company's remuneration committee will not be binding on the trustees, as a practical matter, the trustees would normally act on the remuneration committee's recommendations unless this would be contrary to or beyond their powers and duties.

### **Gifts of shares**

Gifts of shares may be structured in three different ways:

- (a) **Provisional allocations:** Participants may receive an award of shares which is a "provisional allocation" of shares giving no right to receive shares for a fixed period. Shares are in effect earmarked for employees. The release of shares by the trustees would normally be subject to the trustees' discretion and the employee concerned remaining in the employment of the company. The release of shares may also be subject to the satisfaction of performance targets.
  
- (b) **Nil cost options:** The gift of shares may be structured as a "nil cost option". The employee is granted an option with a nominal exercise price, e.g. £1.
  
- (c) **Restricted shares:** Participants may be given shares from the outset but the shares are subject to restrictions (no right to vote, dispose of shares or receive dividends etc) which lapse after a fixed period of time.

### **Purchase of shares**

There are in essence two types of share purchase scheme:

- (a) **Share option schemes:** Under a share option scheme, participants would be able to exercise options after a fixed period for a fixed period. The exercise price per share would normally be fixed at the date of grant by reference to the market value of a company's shares. Provision is usually made for earlier exercise, for example on redundancy, retirement or on a takeover of the company. The exercise of options may also be conditional on the satisfaction of performance targets.
  
- (b) **Restricted share schemes:** As described above, participants may purchase shares which are subject to contractual restrictions which lapse after a fixed period of time.

### **Bonus-linked schemes**

Such share schemes are often linked to cash bonus schemes where the award of shares is regarded as the deferred element of a cash bonus scheme, i.e. the employee would receive an annual cash bonus and a deferred element in the form of shares.

## **APPENDIX B**

### **PART A: NEW NOTE ON RULE 9.1**

#### *"5. Employee Benefit Trusts*

*The Panel must be consulted in advance of any proposed acquisition of new or existing shares if the aggregate holdings of the directors, any other shareholders acting, or presumed to be acting, in concert with any of the directors and the trustees of an employee benefit trust ("EBT") will, as a result of the acquisition, equal or exceed 30% of the voting rights or, if already exceeding 30%, will increase further. The Panel must also be consulted in any case where a shareholder (or a group of shareholders acting, or presumed to be acting, in concert) holds 30% or more (but not more than 50%) of the voting rights and it is proposed that an EBT acquires shares.*

*The mere establishment and operation of an EBT will not by itself give rise to a presumption that the trustees are acting in concert with the directors. The Panel will, however, consider all relevant factors including: the identities of the trustees; the composition of any remuneration committee; the nature of the funding arrangements; the percentage of the issued share capital held by the EBT; the number of shares held to satisfy awards made to directors; the number of shares held in excess of those required to satisfy existing awards; and the prices at which, method by which and persons from whom existing shares have been or are to be acquired. Its consideration of these factors may lead the Panel to deem the trustees to be acting in concert with the directors.*

*Where a majority of the directors or any holder of a significant office are representatives of, or are otherwise closely connected with, a controlling shareholder (or group of shareholders acting, or presumed to be acting, in concert), the controlling shareholder (or that group) will be deemed to be acting in concert with the trustees.*

*The directors will be presumed to be acting in concert with the trustees if the directors themselves are presumed to be acting in concert, most notably during an offer period or when the directors have reason to believe that a bona fide offer might be imminent.*

*Any presumption of concertedness will not apply in respect of shares held within the EBT but controlled by the beneficiaries."*

**PART B: New Note 5 on SAR 5**

*"5. Employee Benefit Trusts*

*Persons who are deemed to be acting in concert pursuant to Note 5 on Rule 9.1 will be deemed to be acting by agreement or understanding for the purposes of SAR 5."*