

# THE TAKEOVER PANEL

## PRACTICE STATEMENT NO. 23

### **RULE 21.2 – INDUCEMENT FEE AGREEMENTS AND OTHER AGREEMENTS BETWEEN AN OFFEROR AND THE OFFEREE COMPANY**

#### **1. Introduction**

1.1 Rule 21.2 provides that certain safeguards must be observed prior to an offeree company agreeing to pay an inducement fee to an offeror. These include a requirement that the inducement fee must be de minimis, the test for which is that it must normally be no more than 1% of the value of the offeree company calculated by reference to the offer price. The primary rationale for this limit (and Rule 21.2 generally) is to prevent the possible payment of an inducement fee from frustrating a competing bid.

1.2 The purpose of this Practice Statement is to clarify the way in which the Executive applies Rule 21.2 to inducement fee agreements and certain other agreements between an offeror and the offeree company.

#### **2. Agreements between an offeror and the offeree company**

2.1 The first two paragraphs of Note 1 on Rule 21.2 state that:

*“An inducement fee is an arrangement which may be entered into between an offeror or a potential offeror and the offeree company pursuant to which a cash sum will be payable by the offeree company if certain specified events occur which have the effect of preventing the offer from proceeding or causing it to fail (e.g. the recommendation by the offeree company board of a higher competing offer).*

*This Rule will also apply to any other favourable arrangements with an*

*offeror or potential offeror which have a similar or comparable financial or economic effect, even if such arrangements do not actually involve any cash payment.”.*

- 2.2 The Executive is consulted about the application of Rule 21.2 to a range of agreements between offerors and offeree companies. These agreements (which are frequently described as “Implementation Agreements” or “Exclusivity Agreements”) may impose a variety of restrictions on offeree companies, for example, seeking to restrict the offeree company from soliciting other offers. Such restrictions are sometimes in addition to the agreement by the offeree company to pay an offeror an inducement fee of up to 1% of the offer value if a higher offer is recommended by the offeree company board or if certain other specified events occur.
- 2.3 The Executive regards payments pursuant to, or for any breach of, such an agreement in respect of any matter which has the effect of preventing the offer from proceeding, or of causing it to fail, (because, for example, the offeree board successfully solicits a higher bid) as falling within Rule 21.2. In addition, the Executive regards payments in respect of offer-related costs, losses and expenses pursuant to, or for any breach of, such an agreement as falling within the scope of Rule 21.2. For example, the Executive would regard a payment in respect of the breach of an undertaking not to solicit other offers as falling within Rule 21.2. This is on the basis that any such payments would have a similar or comparable financial or economic effect to an inducement fee pursuant to the second paragraph of Note 1 on Rule 21.2. Where relevant, references to “inducement fees” in the remainder of this Practice Statement include such payments. Therefore, the maximum total payments that may be made by the offeree company to an offeror in respect of offer-related costs, losses and expenses (including any inducement fee) should be 1% of the value of the offeree company calculated by reference to the offer price.
- 2.4 The Executive recognises that payments by the offeree company in respect of matters which have not prevented the offer from proceeding or caused it to

fail, or which are not otherwise in respect of offer-related costs, losses and expenses, will normally fall outside Rule 21.2. For example, the Executive would not normally regard the payment of damages in respect of a loss suffered by an offeror as a result of a breach of a confidentiality undertaking as falling within the scope of Rule 21.2.

- 2.5 The Executive is concerned to ensure that agreements entered into by offeree companies are consistent with the provisions of the Code. Therefore, when consulted in cases where an inducement fee or similar arrangement is proposed (as required by Rule 21.2), the Executive will normally require all relevant agreements to include a clause as follows:

“Nothing in this agreement shall oblige [the offeree company] to pay any amount which the Panel determines would not be permitted by Rule 21.2 of the City Code on Takeovers and Mergers.”

### **3. Calculation of the maximum amount payable**

- 3.1 In determining the maximum amount permitted for an inducement fee, the Executive will normally consider that:
- (a) the 1% limit can be calculated on the basis of the fully diluted equity share capital of the offeree company, but taking into account only those options and warrants that are “in the money”. When determining the value of the fully diluted equity share capital, the Executive will consider the value attributable to options and warrants to be their “see through” value (being their value by reference to the value of the offer for the shares to which they relate, net of any exercise price). The Executive will consider the value attributable to convertible securities to be the offer price for the shares into which the convertible securities may be converted multiplied by the conversion ratio;
  - (b) any VAT payable as a result of the payment of an inducement fee to an offeror should be taken into account in determining whether the 1%

limit would be exceeded (except to the extent that such VAT is recoverable by the offeree company); and

- (c) in a securities exchange offer, the value of the offeree company will be fixed by reference to the value of the offer as stated in the firm offer announcement and will not fluctuate as a result of subsequent movements in the price of the consideration securities.

3.2 Where an inducement fee is agreed prior to the announcement of a firm intention to make an offer, the 1% limit may be calculated by reference to:

- (a) the expected value of the offer at the time the inducement fee is agreed;  
or
- (b) the value of the offeree company by reference to the offer price as stated in a subsequent firm offer announcement.

If the inducement fee is calculated by reference to the expected value of the offer at the time the inducement fee is agreed, the agreement should provide that, if the value of the offeree company by reference to the offer price as stated in the firm offer announcement is lower than the expected value of the offer at the time the inducement fee was agreed, the maximum inducement fee payable shall be scaled back to an amount representing not more than 1% of that lower value.

3.3 The Executive also interprets Rule 21.2 as permitting an offeree company to agree inducement fees with two or more offerors or potential offerors, each up to the relevant 1% limit, notwithstanding that, in certain circumstances, the aggregate amount payable by the offeree company in respect of all such inducement fees might exceed 1% of the value of the offeree company.

#### **4. Confirmations to the Executive**

4.1 A further safeguard which must be observed prior to agreeing to pay an

inducement fee is that the offeree company board and its financial adviser must provide certain written confirmations to the Panel.

- 4.2 Each of the offeree company board and its financial adviser must give separate written confirmations, or a single confirmation, signed by, or on behalf of, both the offeree company board and the financial adviser. A letter from the financial adviser on behalf of the board will not be acceptable.
- 4.3 The written confirmations should normally address the following points:
- (a) confirmation that the inducement fee was agreed as a result of arms' length commercial negotiations;
  - (b) an explanation of the circumstances in which the inducement fee will become payable and the basis on which such circumstances were considered appropriate;
  - (c) any relevant information concerning possible competing offerors, for example, the status of any discussions, the possible offer terms, any pre-conditions to the making of an offer and the timing of any such offer;
  - (d) confirmation that there are no side agreements or understandings in relation to the inducement fee that have not been fully disclosed; and
  - (e) confirmation that, in the opinion of the offeree company board and its financial adviser, the agreement to pay the inducement fee is in the best interests of offeree company shareholders.

The Executive should be consulted at the earliest opportunity in all cases where an inducement fee or any similar arrangement is proposed.

*Practice Statements are issued by the Executive to provide informal guidance to companies involved in takeovers and practitioners as to how the Executive normally interprets and applies relevant provisions of the Code in certain circumstances. Practice Statements do not form part of the Code. Accordingly, they are not binding on the Executive or the Panel and are not a substitute for consulting the Executive to establish how the Code applies in a particular case. All Practice Statements issued by the Executive are available on the Panel's website at [www.thetakeoverpanel.org.uk](http://www.thetakeoverpanel.org.uk).*

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