

RS 13 Issued on 28 November 2003

THE PANEL ON TAKEOVERS AND MERGERS

**TREASURY SHARES: REVISION PROPOSALS
RELATING TO THE DEFINITIONS OF
THE TAKEOVER CODE AND THE SARS AND
TO NOTE 7 ON RULE 21.1**

**STATEMENT BY THE CODE COMMITTEE OF THE
PANEL FOLLOWING THE EXTERNAL CONSULTATION
PROCESS ON PCP13**

1. Introduction

- 1.1 On 30 April, the Code Committee of the Takeover Panel (“the Code Committee”) published a public consultation paper (“PCP13”) entitled “Treasury Shares: Revision Proposals Relating to the Definitions of the Takeover Code and the SARs and to Note 7 on Rule 21.1”.
- 1.2 On 24 July, following the expiry of the consultation period, the Code Committee announced that it had deferred publication of a Response Statement in connection with PCP13. This was due to the fact that the Department of Trade and Industry (“DTI”) was considering further whether, in order for the compulsory purchase provisions contained in Sections 428 to 430F of the Companies Act 1985 to be applied, the law would require an offer to be made in respect of all the shares in the offeree company in issue (including those held in treasury) and, if so, whether appropriate amendments should be made to those provisions.
- 1.3 On 27 November, The Companies (Acquisition of Own Shares) (Treasury Shares) No.2 Regulations 2003 (“the No.2 Regulations”) were laid before Parliament. These regulations, which come into force on 18 December, amend Sections 428 and 429 of the Companies Act 1985 to provide that the compulsory purchase provisions will be available to an offeror if it has reached the relevant 90 per cent threshold whether or not its offer extends to treasury shares in the offeree company. As a result, there will be no requirement for an offer to extend to treasury shares in order for the compulsory purchase provisions to be available. However, an offeror will have the option to extend its offer to treasury shares if it so wishes. In addition, an offeror will need to consider how to deal with the possibility that shares may become treasury shares or may cease to be treasury shares during the course of the offer.
- 1.4 Now that this issue has been resolved, the Code Committee is in a position to provide details of its response to the external consultation process on PCP13. In addition, the Code Committee has considered whether any further changes

need to be made to the Code on account of the fact that an offer may extend to treasury shares. As explained in paragraph 4.14(a) below, the Code Committee has concluded that one amendment does need to be made to the Code in this context.

2. Number of responses received

- 2.1 A total of 9 responses were received from a range of parties, including shareholder representative organisations and legal practitioners.

3. Significant conflicts of views

- 3.1 Subject to clarification on the key point of whether an offer had to extend to treasury shares in order for the compulsory purchase provisions to be available and on the other issues referred below, the respondents were supportive of the proposed amendments to the Code and the SARs.

4. The Code Committee's conclusions

Question 1: do you agree that the Definitions in the Code and the SARs should be amended in the manner suggested to take account of the introduction of treasury shares?

- 4.1 Almost all the respondents agreed that the Definitions in the Code and the SARs should be amended in the manner suggested, namely that there should be a new provision in the Definitions relating to treasury shares which would provide that:

- (a) all percentage holdings of voting rights, share capital and relevant securities are to be calculated by reference to the relevant percentage held and in issue outside treasury at the relevant time; and
- (b) a transfer of shares by a company from treasury will normally be treated in the same way as an issue of new shares and, therefore,

references in the Code and the SARs to issues of new shares should be interpreted accordingly.

- 4.2 Under section 162D of the Companies Act 1985, treasury shares can only be transferred out of treasury for the purposes of or pursuant to an employees' share scheme. Otherwise, they may only be sold for cash or cancelled. Following recent conversations with the DTI, the Code Committee believes that it would be helpful to draw attention to this distinction between transfers and sales. In the light of this, the Definitions in the Code and the SARs will be amended as follows:

“Treasury shares

All percentage holdings of voting rights, share capital and relevant securities are to be calculated by reference to the relevant percentage held and in issue outside treasury. A transfer or sale of shares by a company from treasury will normally be treated in the same way as an issue of new shares.”

- 4.3 Two respondents questioned whether it was appropriate to include the new provision in the Definitions of the Code and the SARs given that it did not define what a treasury share was. The Code Committee considered this issue prior to the publication of PCP13 and concluded that the Definitions section of the Code and the SARs was the most appropriate place in which to include the new provision.

Question 2: do you agree that no amendment needs to be made to the Code or to the SARs to require the disclosure of transfers of shares into and out of treasury and of the cancellation of shares held in treasury?

- 4.4 All the respondents agreed that no amendment needed to be made to the Code or to the SARs to require the disclosure of transfers of shares into and out of treasury and of the cancellation of shares held in treasury.

Question 3: do you agree that the disclosure forms should be amended in the manner suggested?

- 4.5 All the respondents agreed that the disclosure forms should be amended in the manner suggested save that one respondent correctly pointed out that, in respect of Form SAR5, the new Note will be the only Note on the form and so should not be numbered Note 2. In addition, the new Note on the Form 8.1/8.3 will be included as Note 7 and not Note 1 so as to avoid having to re-number the existing Notes on the Form.

Question 4: do you agree that Note 13 on Rule 8 should be amended in the manner suggested?

- 4.6 All the respondents agreed with the proposed amendment to make clear that the 1% threshold for the purpose of Rule 8.3 should be calculated by reference to the percentage of the class of relevant security held and in issue outside treasury. However, certain respondents suggested that the amendment should be made to Note 2 on Rule 8, which explains the meaning of the term ‘relevant securities’, and not to Note 13 on Rule 8. The Code Committee agrees with this and also proposes that the amendment should make clear not only that the 1% threshold for the purpose of Rule 8.3 should be calculated on the basis described but also that it is only shares which are held and in issue outside treasury which are relevant to Rule 8 generally. For example, in calculating the resultant total percentage shareholding, no account should be taken of shares held in treasury. As a result, the Code Committee has concluded that Note 2 on Rule 8 should be amended by including the following wording in a new paragraph at its end.

“All percentage holdings of relevant securities are to be calculated by reference to the percentage of the class of relevant security held and in issue outside treasury – see the reference to treasury shares in the Definitions.”

Question 5: do you agree with the proposed new Note 16 on Rule 9.1?

- 4.7 The proposed new Note 16 on Rule 9.1 provides that where an obligation to make an offer is incurred under Rule 9, it is not necessary for the offer to extend to shares in the offeree company held in treasury. Certain respondents questioned whether this amendment was appropriate given that, prior to introduction of the No.2 Regulations, an offeror would not have been able to invoke the compulsory purchase provisions in the Companies Act 1985 if the offer did not extend to treasury shares. However, on the basis that the No.2 Regulations will clarify that the compulsory purchase provisions will be available to an offeror whether or not its offer extends to treasury shares, the Code Committee believes that the amendment is helpful and should be retained.

Question 6: do you agree that Note 3 on Rule 10 should be amended in the manner suggested?

- 4.8 All the respondents agreed that Note 3 on Rule 10 should be amended in the manner suggested to require an offeree company to provide the offeror with details of the extent to which any of its issued share capital is held in treasury. A number of respondents also suggested that the Note should go on to require the offeree company to notify the offeror of the extent to which it has agreed to transfer (or sell) any shares out of treasury. The Code Committee agrees with this suggestion and, accordingly, the first paragraph of Note 3 on Rule 10 will be amended as follows:

“Following the announcement of a firm intention to make an offer, the offeree company must, on request, provide the offeror as soon as possible with all relevant details of the issued shares (including the extent to which any such shares are held in treasury and details of any agreements to transfer or sell such shares out of treasury) and, to the extent not issued, the allotted shares and details of any conversion or subscription rights or any other rights pursuant to the exercise of which shares may be unconditionally allotted or issued during the offer period.”

Question 7: do you agree that Note 7 on Rule 21.1 should be amended in the manner suggested?

- 4.9 All the respondents agreed that the issue of new shares (or the transfer of shares from treasury) to satisfy the exercise of employee share options should not be prohibited under Rule 21.1. However, certain respondents believed that the Code should make clear whether the Panel's consent was required for an issue of shares (and hence for a transfer of shares from treasury) for these purposes in circumstances where Rule 21.1 is in point. The Code Committee believes that it should be necessary for the Panel's consent to be obtained and, accordingly, Note 7 on Rule 21.1 will be amended as follows:

"7. Established share option schemes

Where the offeree company proposes to grant options over shares, the timing and level of which are in accordance with its normal practice under an established share option scheme, the Panel will normally give its consent. Likewise, the Panel will normally give its consent to the issue of new shares or to the transfer of shares from treasury to satisfy the exercise of options under an established share option scheme."

- 4.10 The inclusion of the words "or to the transfer of shares from treasury" is as a consequence of the amendment to Rule 21.1(a) referred to in paragraph 4.11 below.
- 4.11 Certain respondents also questioned whether there should be a specific amendment to Rule 21.1 to make clear that the board of an offeree company must not transfer (or sell) shares out of treasury during the course of an offer or at a time when it has reason to believe that a bona fide offer might be imminent, except in the circumstances permitted by the Rule. In the light of the fact that Rule 21.1(a) prohibits the board of an offeree company from issuing "any authorised but unissued shares", and given that treasury shares comprise part of a company's issued share capital, the Code Committee

considers that it may be preferable to put this issue beyond doubt and so Rule 21.1 will be amended as follows:

“21.1 WHEN SHAREHOLDERS’ CONSENT IS REQUIRED

During the course of an offer, or even before the date of the offer if the board of the offeree company has reason to believe that a bona fide offer might be imminent, the board must not, except in pursuance of a contract entered into earlier, without the approval of the shareholders in general meeting:

- (a) issue any authorised but unissued shares or transfer or sell, or agree to transfer or sell, any shares out of treasury;”.**

Question 8: do you agree that Rule 37.3(c) and Rule 37.4(b) should be amended in the manner suggested?

4.12 All respondents agreed that Rules 37.3(c) and 37.4(b) should be amended in the manner suggested to require the offeree company and the offeror respectively to disclose in the documents sent to shareholders in the offeree company the extent to which shares which they repurchased in the offer period and during the twelve months prior to its commencement were cancelled or held in treasury.

4.13 One respondent thought that it would be helpful to clarify in the first line of Rule 37.1 that a redemption or purchase of shares includes a purchase of shares into treasury. The Code Committee considers that this is already clear and does not believe that an amendment to the Code is necessary.

Question 9: do you agree that only the amendments proposed should be made to the Code and to the SARs to take account of the introduction of treasury shares?

4.14 All the respondents agreed that no other amendments needed to be made to the Code or to the SARs to take account of the introduction of treasury shares, assuming that offers did not extend to treasury shares. However, certain respondents enquired as to how a number of the Rules of the Code would be applied in the event that an offer extended to treasury shares. Having considered these and other matters, the Code Committee has concluded that where an offer extends to treasury shares, the position should be as follows:

- (a) new Rule 4.5: the Code Committee understands that in view of Section 162D(1)(a) of the Companies Act 1985 a company may assent treasury shares to a cash offer on the basis that this is a sale of such shares for cash (although the company will need to consider whether the requirements of Section 89 of the Companies Act 1985 (statutory pre-emption rights) have been disapplied (or complied with) so as to permit this). However, a company may not assent treasury shares to a securities exchange offer as this is not permitted by Section 162D. In the light of this, two respondents pointed out that in a situation where a share offer was competing with a cash offer (and the latter extended to treasury shares), there would potentially be scope for the offeree company to determine which of the two offers was successful, particularly if it held the maximum 10% stake in treasury. In addition, even in the absence of a competing situation, an offeree board could assist a recommended cash offeror in satisfying its acceptance condition by assenting treasury shares to the offer.

The Code Committee does not believe that it is appropriate that the outcome of an offer should be capable of being influenced through a decision taken by the board of an offeree company in respect of the company's treasury shares. Accordingly, the Code Committee has concluded that an offeree company should be prohibited from assenting treasury shares to an offer until after the offer is unconditional as to acceptances. This restriction will be included in a new Rule 4.5 which will provide as follows:

“4.5 RESTRICTION ON THE OFFEREE COMPANY ACCEPTING AN OFFER IN RESPECT OF TREASURY SHARES

An offeree company may not accept an offer in respect of treasury shares until after the offer is unconditional as to acceptances.”

- (b) Rule 10: on the basis that the Rule 10 acceptance condition (and the Rule 9.3 acceptance condition where the offer is mandatory) will only be satisfied once an offeror has acquired or agreed to acquire shares carrying over 50% of the offeree company’s voting rights, and given the new provision in the Definitions of the Code relating to treasury shares (which takes account of the fact that voting rights attaching to shares are suspended while they are held in treasury), Rule 10 (and Rule 9.3) is clear that treasury shares should not be taken into account in either the numerator or the denominator in establishing whether an offer is unconditional as to acceptances, even if the offer extends to treasury shares. The new Rule 4.5 will act as a further safeguard in this respect. However, where an offer extends to treasury shares, offerors and their advisers should take account of the following in drafting the acceptance condition and the terms of the offer:
- (i) that, in the light of Note 2 on Rule 10 and the new provision in the Definitions relating to treasury shares, all shares which are transferred (or sold) out of treasury before the offer becomes or is declared unconditional as to acceptances should be taken into account in establishing whether the acceptance condition is satisfied; and
 - (ii) that, in the light of the third paragraph of Note 3 on Rule 10 and the new provision in the Definitions relating to treasury shares, appropriate arrangements are put in place to ensure that any person to whom shares of a type to which the offer relates are transferred (or sold) out of treasury during the offer period

will have the opportunity of accepting the offer in respect of such shares.

However, in view of the new provision in the Definitions relating to treasury shares, the Code Committee does not believe that any amendments need to be made to the Code on account of these issues. Offerors and their advisers should also consider whether the amendments which will be made by the No.2 Regulations to Sections 428 and 429 of the Companies Act 1985 will need to be factored into the drafting of the acceptance condition and the terms of the offer.

- (c) Rule 17.1: on the basis that the purpose of Rule 17.1 is to require the offeror to keep shareholders in the offeree company and the market generally informed of its progress in satisfying the acceptance condition, and in the light of what is said in respect of Rule 10 in paragraph (b) above, treasury shares should not be taken into account in announcements made in accordance with the Rule. However, the Code Committee does not believe that any amendment needs to be made to the Code to reflect this.

- (d) Rule 21.2: the 1% limit on the amount of an inducement fee should be determined on the basis of the value of the offeree company calculated by reference to the offer price excluding treasury shares. This is because although treasury shares may be subject to the offer (with the result that one might have expected them to be taken into account in determining the 1% limit), the funds spent in acquiring the treasury shares will remain under the control of the offeror following completion of the offer. As a result, the total spend of the offeror in acquiring the offeree company will not include these funds with the consequence that they should not be taken into account in determining the 1% limit for the purpose of Rule 21.2. However, the Code Committee does not believe that the Code needs to be amended to reflect this.

- (e) Rule 24.7: where the offer extends to treasury shares, the cash confirmation should take account of shares held in treasury. This is because the purpose of Rule 24.7 is to ensure that the offeror has sufficient cash resources to satisfy full acceptance of the offer. However, again, no amendment to the Code is required.

In the event of there being any doubt as to the application of any other Rules of the Code to an offer which extends to treasury shares, the Panel should be consulted.

- 4.15 Earlier this year Rule 2.10 was introduced to require offeror and offeree companies to announce details of their relevant securities in issue at the commencement of the offer period together with details of any changes to that information which occur during the offer period. In the consultation paper on Rule 2.10 (PCP14) the Code Committee proposed that there should be a Note on Rule 2.10 to make clear that only relevant securities which are held and in issue outside treasury should be included in announcements made in accordance with the Rule. All the respondents agreed with this Note and the amendment is now being made.

5. Amendments to the Code and to the SARs

The Appendix to this document sets out in full the text of the provisions of the Code and the SARs which have been added or amended as a result of the introduction of treasury shares, taking into account the changes made following the consultation exercise as referred to above.

APPENDIX

AMENDMENTS TO THE CODE

DEFINITIONS

“Treasury shares

All percentage holdings of voting rights, share capital and relevant securities are to be calculated by reference to the relevant percentage held and in issue outside treasury. A transfer or sale of shares by a company from treasury will normally be treated in the same way as an issue of new shares.”

Rule 2.10

NOTES ON RULE 2.10

“1. Relevant Securities

See Note 2 on Rule 8.

2. Treasury shares

Only relevant securities which are held and in issue outside treasury should be included in the announcement.”

Rule 4.5

“4.5 RESTRICTION ON THE OFFEREE COMPANY ACCEPTING AN OFFER IN RESPECT OF TREASURY SHARES

An offeree company may not accept an offer in respect of treasury shares until after the offer is unconditional as to acceptances.”

Rule 8

NOTES ON RULE 8

“2. *Relevant securities*

Relevant securities for the purpose of Rule 8 include:–

- (a) securities of the offeree company which are being offered for or which carry voting rights;*
- (b) equity share capital of the offeree company and an offeror;*
- (c) securities of an offeror which carry substantially the same rights as any to be issued as consideration for the offer;*
- (d) securities of the offeree company and an offeror carrying conversion or subscription rights into any of the foregoing; and*
- (e) options in respect of any of the foregoing and derivatives referenced to any of the foregoing.*

The taking, granting or exercising of an option (including a traded option contract) in respect of any of the foregoing or the exercise or conversion of any security under (d) above whether in respect of new or existing securities and the acquisition of, entering into, closing out, exercise (by either party) of any rights under, or variation of, a derivative will be regarded as a dealing in relevant securities (see also Notes 5 and 7 below).

Disclosure of dealings in relevant securities of an offeror is only required (a) following the announcement of a securities exchange offer, or (b) following the earlier commencement of an offer period, if it has not been announced that any offer is likely to be solely in cash.

All percentage holdings of relevant securities are to be calculated by reference to the percentage of the class of relevant security held and in issue outside treasury – see the reference to treasury shares in the Definitions.”

FORM 8.1/8.3

“Note 1. Specify owner, not nominee or vehicle company. If relevant, also identify controller of owner, eg where an owner normally acts on instructions of a controller.

Note 2. Disclosure might be made for more than one reason; if so, state all reasons.

Note 3. Specify which offeror if there is more than one.

Note 4. When an arrangement exists with any offeror, with the offeree company or with an associate of any offeror or of the offeree company in relation to relevant securities, details of such arrangement must be disclosed, as required by Note 6 on Rule 8.

Note 5. It may be necessary, particularly when disclosing derivative transactions, to append a sheet to this disclosure form so that all relevant information can be given.

Note 6. In the case of an average price bargain, each underlying trade should be disclosed.

Note 7. The resultant total percentage holding of the class of relevant security is to be calculated by reference to the percentage held and in issue outside treasury.”

Rule 9.1*NOTES ON RULE 9.1**“16. Treasury shares*

When an obligation to make an offer is incurred under this Rule, it is not necessary for the offer to extend to shares in the offeree company held in treasury.”

Rule 10*NOTES ON RULE 10*

“3. Information to offeror during offer period and extension of offer to new shares.

Following the announcement of a firm intention to make an offer, the offeree company must, on request, provide the offeror as soon as possible with all relevant details of the issued shares (including the extent to which any such shares are held in treasury and details of any agreements to transfer or sell such shares out of treasury) and, to the extent not issued, the allotted shares and details of any conversion or subscription rights or any other rights pursuant to the exercise of which shares may be unconditionally allotted or issued during the offer period. In the case of conditionally allotted shares, the details should include the conditions and the date on which such conditions may be satisfied. In the case of rights, the details should include the number of shares which may be unconditionally allotted or issued during the offer period as a result of the exercise of such rights, identifying separately those attributable to rights which commence or expire on different dates, and the various prices at which these rights could be exercised.

The offeree company must immediately notify the offeror of any allotment or issue of shares and of the exercise of any such rights during the offer period and provide the offeror as soon as possible with all relevant details.

The offeror must make appropriate arrangements to ensure that any person to whom shares of a type to which the offer relates are unconditionally allotted or issued during the offer period will have an opportunity of accepting the offer in respect of such shares.

In cases of doubt, the Panel must be consulted.”

Rule 21.1

“21.1 WHEN SHAREHOLDERS’ CONSENT IS REQUIRED

During the course of an offer, or even before the date of the offer if the board of the offeree company has reason to believe that a bona fide offer might be imminent, the board must not, except in pursuance of a contract entered into earlier, without the approval of shareholders in general meeting:

- (a) issue any authorised but unissued shares or transfer or sell, or agree to transfer or sell, any shares out of treasury;**
- (b) issue or grant options in respect of any unissued shares;**
- (c) create or issue, or permit the creation or issue of, any securities carrying rights of conversion into or subscription for shares;**
- (d) sell, dispose of or acquire, or agree to sell, dispose of or acquire, assets of a material amount; or**
- (e) enter into contracts otherwise than in the ordinary course of business.**

The notice convening such a meeting of shareholders must include information about the offer or anticipated offer.

Where it is felt that an obligation or other special circumstance exists, although a formal contract has not been entered into, the Panel must be consulted and its consent to proceed without a shareholders’ meeting obtained.”

*NOTES ON RULE 21.1**“7. Established share option schemes*

Where the offeree company proposes to grant options over shares, the timing and level of which are in accordance with its normal practice under an established share option scheme, the Panel will normally give its consent. Likewise, the Panel will normally give its consent to the issue of new shares or to the transfer of shares from treasury to satisfy the exercise of options under an established share option scheme.”

Rule 37.3**“(c) Disclosure in the offeree board circular.**

The offeree board circular advising shareholders on an offer must state the amount of relevant securities of the offeree company which the offeree company has redeemed or purchased during the period commencing 12 months prior to the offer period and ending with the latest practicable date prior to the posting of the document, and the details of any such redemptions and purchases, including dates and prices and the extent to which the shares redeemed or purchased were cancelled or held in treasury.”

Rule 37.4**“(b) Disclosure in the offer document**

The offer document must state (in the case of a securities exchange offer only) the amount of relevant securities of the offeror which the offeror has redeemed or purchased during the period commencing 12 months prior to the offer period and ending with the latest practicable date prior to the posting of the offer document and the details of any such redemptions and purchases, including dates and prices and the extent to which the shares redeemed or purchased were cancelled or held in treasury.”

THE SARS

DEFINITIONS

“Treasury shares

All percentage holdings of voting rights and share capital are to be calculated by reference to the relevant percentage held and in issue outside treasury. A transfer or sale of shares from treasury will normally be treated in the same way as an issue of new shares.”

FORM SAR3

“Note 1. Under SAR5, the holdings of and acquisitions by persons acting by agreement or understanding must be aggregated and treated as a holding of or acquisition by one person. Note 3 on SAR5 requires persons who must aggregate holdings to disclose certain disposals.

Note 2. The resultant total percentage holding of voting shares and rights over shares is to be calculated by reference to the percentage held and in issue outside treasury.”

FORM SAR5

“Note. The resultant total percentage holding of voting shares and rights over shares is to be calculated by reference to the percentage held and in issue outside treasury.”