



RS6 Issued on 21 February 2002

THE PANEL ON TAKEOVERS AND MERGERS

**PURCHASES BY THE OFFEROR OF SHARES IN THE OFFEREE IN
EXCHANGE FOR SECURITIES**

STATEMENT BY

THE CODE COMMITTEE OF THE PANEL

FOLLOWING THE EXTERNAL CONSULTATION PROCESS ON PCP

1. Introduction

- 1.1 In October 2001 the Code Committee of the Takeover Panel published a Public Consultation Paper (PCP 6) on purchases by the offeror of shares in the offeree in exchange for securities.
- 1.2 The proposals in PCP 6 sought to amend the Code so that, in certain circumstances, a securities offer will be required. Other related changes to Rule 11 of the Code were also proposed.
- 1.3 The purpose of this paper is to provide details of the Code Committee's response to the external consultation process on PCP 6.

2. Number of Responses Received

A total of six responses were received, the majority of which were from major industry bodies and investment banks.

3. Significant Conflicts of View

Questions were asked in respect of nine separate points and, whilst certain respondents expressed concerns about the detail of some of the proposals, the balance of those in favour of each proposed change was significant.

4. The Code Committee's Conclusions

- (a) **Question 1: Do you agree that, in certain circumstances, where purchases of offeree shares have been made in exchange for securities, there should be a requirement for the offeror to provide a share offer? If so, do you agree that (a) as regards size, the requirement should not be triggered (save as envisaged by Note 2)**

by a purchase of offeree securities of less than 10% and (b) as regards timing (save as envisaged by Note 2) only purchases made in the three months prior to the commencement of and during the offer period should trigger the requirement?

and

- (b) Question 2: Do you agree that any shares required to be offered pursuant to the proposed new Rule 11.2 should be offered on the basis of the same number of securities received by the vendor rather than on the basis of securities equivalent to the value of the securities received by the vendor at the time of the relevant purchase?**

- 4.1 There was significant support in favour of the above proposals. However, a number of respondents were concerned that adopting the "same number" basis for determining the level of a securities offer might lead to unfairness where some form of corporate action on the part of the offeror and/or the offeree (such as a rights issue or a share split) had taken place or dividend payments had been made. The Panel does not, unless the relevant facts are exceptional, make adjustments to the required level of a bid to take account of dividend payments. However, it does take into account corporate action if, as a result, all shareholders would not be treated equally. In addition, where any special features, such as contingent value rights, attach to any securities offered to a vendor the Panel would, as a matter of course, require such special features to be attached to the securities to be made available under any offer. The equality of treatment of all shareholders is, of course, one of the Panel's principal concerns and the Code Committee is satisfied that none of the proposed changes to the Code would undermine the Panel's ability to achieve this.
- 4.2 In addition, it was brought to the Code Committee's attention by two respondents that the proposals might create confusion in connection with the interaction of the proposed new Rule 11.2 with Rule 6.1 in that, without clarification, Rule 6.1 could be interpreted as requiring a bid at a value at least equal to the highest relevant purchase price which could, given inevitable changes in the market price of the relevant securities, be at odds with the level of a bid calculated by reference to the "same number" basis. The Code Committee has therefore decided to amend Rule 6.1 to make it clear that compliance with the provisions of Rule 11

(as amended by this statement) will satisfy any other relevant obligation arising under Rule 6.1 and Note 3 on Rule 6 will be amended by referring to Rule 11.1 rather than Rule 11. The additional wording to be added at the end of Rule 6.1 is set out below.

"6.1 PURCHASES BEFORE A RULE 2.5 ANNOUNCEMENT

... If a purchase of shares in the offeree company has given rise to an obligation under Rule 11, compliance with that Rule will normally be regarded as satisfying any obligations under this Rule in respect of those purchases."

- (c) **Question 3: Do you think that the Panel should have the discretion to require a share offer in circumstances wider than those envisaged by the proposed new Rule 11.2 and, if so, should this discretion be restricted to situations where the vendors are directors of, or other persons closely connected with, the offeror or offeree?**

4.3 Respondents were largely in agreement with the proposals. However, it was drawn to the Code Committee's attention that the wording of the proposed Note 2 should be more precise so that the provisions of the Note would apply even though the "*...purchase took place more than 3 months prior to the commencement of the offer period*" [emphasis added] rather than, as previously proposed, "*...some time prior...*" [emphasis added].

4.4 In addition, one respondent felt that the provisions of new Note 2 on proposed Rule 11.2 should more exactly mirror the provisions of Note 4 on Rule 11.1 so that the discretion available to the Panel to require a securities offer should not be limited only to cases where the vendors of the relevant shares are directors of, or other persons closely connected with, either the offeree or the offeror, but that the discretion would *normally* be limited to such circumstances. The Code Committee agrees that there is no reason to differentiate between Rules 11.1 and 11.2 in this regard and it has decided that Note 2 on Rule 11.2 should be amended accordingly.

- 4.5 The revised wording to give effect to the above changes to Note 2 on Rule 11.2 is set out below:

"2. *Equality of treatment*

The Panel may require securities to be offered on the same basis to all other holders of shares of that class even though the amount purchased is less than 10% or the purchase took place more than three months prior to the commencement of the offer period. However, this discretion will not, normally, be exercised unless the vendors of the relevant shares are directors of, or other persons closely connected with, the offeror or the offeree company."

- (d) **Question 4: Do you agree that, where an offeror has purchased offeree company shares in exchange for securities and the offeror or its associates has arranged for the consideration securities to be placed immediately for cash on the vendor's behalf, there should be no obligation on the offeror to provide a securities offer to all shareholders?**

- 4.6 In view of the strong support for this proposal, the Code Committee has decided to adopt Note 3 on proposed Rule 11.2 as set out in PCP 6.

- (e) **Question 5:**

i) Do you think it is acceptable for the offeror in a management buyout or similar transaction not to offer all offeree shareholders equity in the management buyout vehicle even if the management of the offeree will receive equity in respect of their holdings and those holdings amount to more than 10% of the offeree's shares

(ii) Do you think a full securities offer should be required if any such securities are made available to any non-management shareholders regardless of the size of the holding of offeree shares?

- 4.7 As stated in PCP 6, the wording of Note 4 on proposed new Rule 11.2 reflects the Panel's current practice relating to management buyouts and similar transactions and the availability of equity in the offeror vehicle to

management and non-management offeree shareholders. A significant number of respondents, whilst being in agreement with the adoption of the Note, felt that its provisions should not necessarily be triggered by, for example, non-executive directors or relatives of management receiving securities in the offeror. The Panel has historically interpreted the meaning of "management" in this context narrowly, although it has, on occasion, been prepared to interpret the meaning more widely where particular circumstances have persuaded it that it would be appropriate to do so. The Code Committee believes that the concerns expressed by respondents can be met, where appropriate, by the Panel exercising the limited discretion allowed by the wording of Note 4 on Rule 11.2. In addition, the Code Committee does not believe it appropriate, in the context of changes to Rule 11, to introduce a significant policy change in relation to management buyouts. The Code Committee has, therefore, decided that Note 4 should be adopted as set out in PCP 6, save for the changes referred to in paragraph 4.8 below.

4.8 It was also brought to the Code Committee's attention that the reference in Note 4 to *"members of the management of the offeree [who] hold more than 10 % of the offeree's shares"* should be reviewed as it is the amount of offeree shares to be sold by management, not the size of their holding, that is relevant. The Code Committee agrees with this comment and accordingly, the reference to *"hold"* will be replaced by the words *"propose to sell, in exchange for offeror securities,"*.

(f) **Question 6: Do you agree that, where purchases are made by an offeror and any person acting in concert with it in exchange for securities either during or in the 12 months preceding the commencement of an offer period and the vendor is not restricted from selling those consideration securities until either the offer has lapsed or the offer consideration has been posted to accepting shareholders, such purchases should be deemed to have been made for cash?**

4.9 There was general agreement, subject to several minor comments, with this proposal and the Code Committee has, therefore, decided to adopt Note 5 on Rule 11.1 as set out in PCP 6. For the avoidance of doubt, practitioners should note that any obligation which has arisen under Rule 11.2 will have to be complied with even if an obligation under Rule 11.1 has also arisen as a result of Note 5 on Rule 11.1.

(g) **Question 7: Do you agree with the proposal that the Code should require the Panel to be consulted regarding purchases of offeree**

shares for a mix of cash and securities?

- 4.10 All respondents were in favour of this proposal. Some respondents, however, suggested that there should be a more precise definition of a "mix" of cash and securities. The Code Committee is of the opinion that because of the complexities to which mixed purchases can give rise (as referred to in PCP 6) it is appropriate not to have a more precise definition. However, the Code Committee has decided that it would be helpful to revise the wording of the Note in a manner which would make it more consistent with the second part of Note 4 on Rule 11.1. Note 5 on Rule 11.2 will, therefore, be worded as follows:

"5. Acquisitions for a mixture of cash and securities

The Panel should be consulted where 10% or more has been acquired during the offer period and within 12 months prior to its commencement for a mixture of securities and cash."

- (h) **Question 8: Do you agree with the inclusion of Notes 6 and 7 on Rule 11.2?**

and

- (i) **Question 9: Do you agree with the consequential amendments to new Rule 11.3, Rule 7.1 and Note 2 on Rule 32.1?**

- 4.11 These two questions dealt with technical and consequential changes to the Code in connection with the other proposed changes. Support for these changes was widespread and the Code Committee will, therefore, adopt them as set out in PCP 6. In addition, it has been drawn to the Code Committee's attention that three further amendments of a similar nature would be desirable. The Code Committee is in agreement with these suggestions and will, therefore, adopt them. They are:

- (i) to amend new Note 6 on Rule 11.2 to include purchases which take place during an offer period in determining whether the 10% threshold has been reached, so that it would read as follows (changes underlined):

"6. Purchases in exchange for securities to which selling restrictions are attached

Where an offeror and any person acting in concert with it has purchased 10% or more of the voting rights of any class of shares in the offeree company during the offer period and within 12 months prior to its commencement and the consideration received by the vendor includes shares to which selling restrictions of the kind set out in the second sentence of Rule 11.2 are attached, the Panel should be consulted.";

- (ii) to include in new Note 7 on Rule 11.2 ("*Applicability of the Notes on Rule 11.1 to Rule 11.2*") a reference to the applicability of Note 2 on Rule 11.1; and
- (iii) to amend the Note on Rule 12.2 so that the reference to Rule 11.1 becomes a reference to Rule 11.

4.12 The Appendix to this statement sets out in full the changes to the Code proposed in PCP 6, as amended by the further changes discussed in this statement.

APPENDIX

RULE 6. PURCHASES RESULTING IN AN OBLIGATION TO OFFER A MINIMUM LEVEL OF CONSIDERATION

6.1 PURCHASES BEFORE A RULE 2.5 ANNOUNCEMENT

Except with the consent of the Panel in cases falling under (a) or (b), when

an offeror or any person acting in concert with it has purchased shares in the offeree company:-

(a) within the three month period prior to the commencement of the offer period; or

(b) during the period, if any, between the commencement of the offer period and an announcement made by the purchaser in accordance with Rule 2.5; or

(c) prior to the three month period referred to in (a), if in the view of the Panel there are circumstances which render such a course necessary in order to give effect to General Principle 1,

the offer to the shareholders of the same class shall not be on less favourable terms. If a purchase of shares in the offeree company has given rise to an obligation under Rule 11, compliance with that Rule will normally be regarded as satisfying any obligations under this Rule in respect of those purchases.

Notes

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3. *No less favourable terms*

For the purpose of Rule 6.1, except where Rule 9 (mandatory offer) or Rule 11.1 (requirement for cash offer) applies, it will not be necessary to make a cash offer available even if shares have been purchased for cash. However, any securities offered as consideration must, at the date of the announcement of the firm intention to make the offer, have a value at least equal to the highest relevant purchase price. If, during the period ending when the market closes on the first business day after the announcement, the value is not maintained, the Panel will be concerned to ensure that the offeror acted with all reasonable care in determining the consideration.

If there is a restricted market in the securities of an offeror, or if the amount of securities to be issued of a class already listed is large in relation to the amount already issued, the Panel may require justification of prices used to determine

the value of the offer.

RULE 7. CONSEQUENCES OF CERTAIN DEALINGS

7.1 IMMEDIATE ANNOUNCEMENT REQUIRED IF THE OFFER HAS TO BE AMENDED

Purchases of offeree company shares by an offeror or any person acting in concert with it may give rise to obligations under Rule 6 (requirement to increase offer), Rule 9 (mandatory offer) or Rule 11 (nature of consideration to be offered). Immediately after such a purchase, an appropriate announcement must be made. Whenever practicable, the announcement should also state the number of shares purchased and the price paid.

RULE 11. NATURE OF CONSIDERATION TO BE OFFERED

11.1 WHEN A CASH OFFER IS REQUIRED

Except with the consent of the Panel in cases falling under (a) or (b), a cash offer is required where:-

- (a) the shares of any class under offer in the offeree company purchased for cash (but see Note 5) by an offeror and any person acting in concert with it during the offer period and within 12 months prior to its commencement carry 10% or more of the voting rights currently exercisable at a class meeting of that class, in which case the offer for that class shall be in cash or accompanied by a cash alternative at not less than the highest price paid by the offeror or any person acting in concert with it for shares of that class during the offer period and within 12 months prior to its commencement; or**
- (b) subject to paragraph (a) above, shares of any class under offer in the offeree company are purchased for cash (but see Note 5) by an offeror or any person acting in concert with it during the offer**

period, in which case the offer for that class shall be in cash or accompanied by a cash alternative at not less than the highest price paid by the offeror or any person acting in concert with it for shares of that class during the offer period; or

- (c) in the view of the Panel there are circumstances which render such a course necessary in order to give effect to General Principle 1.**

NOTES ON RULE 11.1

1. *Price*

In calculating the price paid, stamp duty and broker's commission should be excluded.

2. *Gross purchases*

The Panel would normally regard Rule 11.1(a) as applying to gross purchases of shares over the relevant period and would not allow the deduction of any shares sold over that period. However, in exceptional circumstances and with the consent of the Panel, shares sold some considerable time before the beginning of the offer period may be deducted.

3. *When the obligation is satisfied*

The obligation to make cash available under this Rule will be considered to have been met if, at the time the purchase was made, a cash offer or cash alternative at a price per share not less than that required by this Rule was open for acceptance, even if that offer or alternative closes for acceptance immediately thereafter.

4. *Equality of treatment*

The discretion given to the Panel in Rule 11.1(c) to require cash to be made available in certain cases where less than 10% has been purchased in the previous 12 months will not normally be exercised unless the vendors are directors of, or other persons closely connected with, the offeror or the offeree company. In such cases, relatively small purchases could be relevant.

Rule 11.1(c) may also be relevant when 10% or more has been acquired in the previous 12 months for a mixture of securities and cash. The Panel should be consulted in all relevant cases.

5. *Acquisitions for securities*

For the purpose of this Rule, shares acquired by an offeror and any person acting in concert with it in exchange for securities, either during or in the 12 months preceding the commencement of the offer period, will normally be deemed to be purchases for cash on the basis of the value of the securities at the time of the purchase. However, if the vendor of the offeree company shares is required to hold the securities received in exchange until either the offer has lapsed or the offer consideration has been posted to accepting shareholders, no obligation under Rule 11.1 will be incurred.

See also Note 6 on Rule 11.2.

6. *Revision*

If an obligation under this Rule arises during the course of an offer period and a revision of the offer is necessary, an immediate announcement must be made (but see Rule 32).

7. *Discretionary clients*

Dealings for discretionary clients by fund managers connected with the offeror, unless they are exempt fund managers, may be relevant (see Rule 7.2).

8. *Allotted but unissued shares*

When shares of a company carrying voting rights have been allotted (even if provisionally) but have not yet been issued, for example, under a rights issue when the shares are represented by renounceable letters of allotment, the Panel should be consulted. Such shares are likely to be relevant for the purpose of calculating percentages under this Rule.

9. *Cum dividend*

When accepting shareholders are entitled under the offer to retain a dividend declared or forecast by the offeree company but not yet paid, the offeror, in establishing the level of the cash offer, may deduct from the highest price paid the net dividend to which offeree company shareholders are entitled.

10. *Convertible securities, warrants and options*

Purchases of convertible securities, warrants, options or other subscription rights will normally only be relevant to this Rule if they are converted or exercised (as applicable). Such purchases will then be treated as if they were purchases of the underlying shares at a price calculated by reference to the purchase price and the relevant conversion or exercise terms. In any case of doubt, the Panel should be consulted.

11. *Offer period*

References to the offer period in this Rule are to the time during which the offeree company is in an offer period, irrespective of whether the offeror was contemplating an offer when the offer period commenced.

12. *Competition reference periods*

If an offer is announced in accordance with Note (a)(iii) on Rule 35.1, any purchases of offeree company shares for cash during the competition reference period will be deemed to be purchases during the new offer period for the purposes of Rule 11.1(b).

11.2 WHEN A SECURITIES OFFER IS REQUIRED

Where purchases of any class of the offeree company shares carrying 10% or more of the voting rights currently exercisable at a class meeting of that class have been made by an offeror and any person acting in concert with it in exchange for securities in the three months prior to the commencement of and during the offer period, such securities will normally be required to be offered to all other holders of shares of that class.

Unless the vendor is required to hold the securities received until either the offer has lapsed or the offer consideration has been posted to accepting shareholders, an obligation to make an offer in cash or to provide a cash alternative will also arise under Rule 11.1.

NOTES ON RULE 11.2

1. Basis on which securities are to be offered

Any securities required to be offered pursuant to this Rule must be offered on the basis of the same number of consideration securities received by the vendor for each offeree company share rather than on the basis of securities equivalent to the value of the securities received by the vendor at the time of the relevant purchase. Where there has been more than one relevant purchase, offeror securities must be offered on the basis of the greater or greatest number of consideration securities received for each offeree company share.

2. Equality of treatment

The Panel may require securities to be offered on the same basis to all other holders of shares of that class even though the amount purchased is less than 10% or the purchase took place more than three months prior to the commencement of the offer period. However, this discretion will not, normally, be exercised unless the vendors of the relevant shares are directors of, or other persons closely connected with, the offeror or the offeree company.

3. *Vendor placings*

Shares acquired in exchange for securities will normally be deemed to be purchases for cash for the purposes of this Rule if an offeror or any of its associates arranges the immediate placing of such consideration securities for cash, in which case no obligation to make a securities offer under this Rule will arise.

4. *Management retaining an interest*

In a management buyout or similar transaction, if the only offeree shareholders who receive offeror securities are members of the management of the offeree company, the Panel will not, so long as the requirements of Note 4 on Rule 16 are complied with, require all offeree shareholders to be offered offeror securities pursuant to Rule 11.2, even though such members of the management of the offeree propose to sell, in exchange for offeror securities, more than 10% of the offeree's shares.

If, however, offeror securities are made available to any non-management shareholders (regardless of the size of their holding of offeree shares), the Panel will normally require such securities to be made available to all shareholders on the same terms.

5. *Acquisitions for a mixture of cash and securities*

The Panel should be consulted where 10% or more has been acquired during the offer period and within 12 months prior to its commencement for a mixture of securities and cash.

6. *Purchases in exchange for securities to which selling restrictions are attached*

Where an offeror and any person acting in concert with it has purchased 10% or more of the voting rights of any class of shares in the offeree company during the offer period and within 12 months prior to its commencement and the consideration received by the vendor includes shares to which selling restrictions of the kind set out in the second sentence of Rule 11.2 are attached,

the Panel should be consulted.

7. *Applicability of the Notes on Rule 11.1 to Rule 11.2*

See Notes 2, 5, 6, 7, 8, 10 and 11 on Rule 11.1 which may be relevant.

In addition, if an offer is announced in accordance with Note (a)(iii) on Rule 35.1, any purchases of offeree company shares for securities during the competition reference period will be deemed to be purchases during the new offer period for the purposes of this Rule.

11.3 DISPENSATION FROM HIGHEST PRICE

If the offeror considers that the highest price (for the purpose of Rules 11.1 and 11.2) should not apply in a particular case, the offeror should consult the Panel, which has discretion to agree an adjusted price.

NOTE ON RULE 11.3

Relevant factors

Factors which the Panel might take into account when considering an application for an adjusted price include:-

- (a) the size and timing of the relevant purchases;*
- (b) the attitude of the offeree board;*
- (c) whether shares have been purchased at high prices from directors or other persons closely connected with the offeror or the offeree company; and*
- (d) the number of shares purchased in the preceding 12 months.*

NOTE ON RULE 12.2

After a reference or initiation of proceedings

Following the ending of an offer period on a reference or initiation of proceedings, General Principle 7 and Rule 21.1 will normally continue to apply (see also Rule 19.8 and the Notes on Rules 6.1, 11, 20.1, 20.2, 35.1 and 35.2 and 38.2).

NOTES ON RULE 32.1

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2. *When revision is required*

An offeror will normally be required to revise its offer if it, or any person acting in concert with it, purchases shares at above the offer price (see Rule 6) or it becomes obliged to make an offer in accordance with Rule 11 or to make a cash offer, or to increase an existing cash offer, under Rule 9.