1989/10

THE TAKEOVER PANEL

PANEL STATEMENT ON THE REPORT OF A PANEL WORKING PARTY ON TAKEOVER RULES AND PRACTICES

1. Introduction

A number of proposals for amending the rules governing takeovers have been publicly discussed in recent months, in particular at the 1988 CBI Conference.

The Panel therefore decided, in November 1988, that it would be appropriate to ask a Working Party, chaired by Lord Rockley, who was at the time the Chairman of the corporate finance committee of the British Merchant Banking and Securities Houses Association, to report to the Panel as to whether any of the issues raised should form the basis of amendments to the Takeover Code.

The Working Party received views from the CBI, The Stock Exchange, the Bank of England, the Association of British Insurers, the National Association of Pension Funds, the British Merchant Banking and Securities Houses Association and the City Capital Markets Committee and from certain industrialists and others.

2. The Role of the Panel

The basic objective of the Panel is to ensure fairness to shareholders of offeree companies in the course of bids, in particular by requiring similarity of treatment between shareholders. It is not, therefore, part of the role of the Panel to adopt rules designed to make bids more, or less, difficult for companies to mount or to defend, although certain Rules of the Code may incidentally have this effect.

Questions of wider public interest are decided by the Secretary of State for Trade and Industry, advised where appropriate by the Office of Fair Trading or the Monopolies and Mergers Commission. Similarly, it is not for the Panel to take a view on the commercial merits of a particular transaction. This is for consideration by offeree company shareholders.

The Panel would, nevertheless, have serious concerns if representatives of industry and commerce, who are the customers of the financial markets, felt that the practices accepted as normal in these markets were unfair and that some correction could be achieved through the medium of the Code. There was some evidence that this might be the case, but the Companies Committee of the CBI considered a series of proposals very similar to those considered by the Panel's Working Party and its rejection of most of the proposed changes was endorsed by the CBI Council in February 1989. On this basis, the list of issues which have been raised and which, in the Panel's view, call for action to be taken is small.

After considering, at a special Panel meeting, a detailed report prepared by the Working Party, the Panel concluded that it would be appropriate to take the following action in relation to the issues raised:-

i) the restrictions imposed in a contested offer on the purchase of offeree company shares by an offeror until after the first closing date of an offer should, where offers fall within the statutory provisions for possible reference to the Monopolies and Mergers Commission, be extended until such time as the Secretary of State has announced whether or not the

offer is to be referred to the Commission and the Panel should have the flexibility to permit the amendment of the subsequent timetable if appropriate;

ii) the 15% level at which a cash alternative is required to be provided under Rule 11 should be reduced to 10% with immediate effect (subject to certain transitional arrangements);

iii) the Panel would support any move by the Department of Trade and Industry to produce a draft notice relating to Section 212 of the Companies Act 1985 to reflect the permissible actions that may be taken by companies under that Section in relation to the disenfranchisement of shares where full beneficial ownership is not disclosed.

The Panel's conclusions in relation to each of the issues considered are summarised below.

3. THE ISSUES

(i) Should the 30% mandatory bid threshold be reduced?

Rule 9 of the Code requires any person or group of persons acting in concert, who acquire 30% or more of the voting rights of a company, to make an offer for all the other shares of that company.

The philosophy underlying this Rule is that if control of a company passes into one hand, all shareholders should have the chance to dispose of their shares at the highest price paid by the new controller. This philosophy is based on two grounds. First, the company is now controlled by a new person, where before it was controlled by another or not controlled at all. In those

circumstances shareholders should be given the chance to sell out of the company as, for a variety of reasons, they may not wish to remain in the company under a new controller. Secondly, the acquiring of control usually involves the payment of a premium over the market price and hence the receipt of a premium by one or more of the vendors. The Panel believes it is right that all shareholders (not just the old controller) should share the premium and hence the imposition of the obligation on the buyer to offer to all shareholders the highest price he paid for his control shares.

Somewhat similar provisions have been in the Code since the Panel began; the figure of 30%, applying in all cases, was introduced in 1974. In discussing the percentage level it is important to distinguish between the two different concepts of influence and control. Over the years the Panel has been aware of virtually no cases where a person or group acting in concert has acquired under 30% of a company and been able to achieve control of that company (other than by making an offer) against the wishes of the board.

One proposal was that the level should be reduced to 25% since that is the level at which a special resolution can definitely be blocked. It is, however, the change in the ability to control the management of the company that should trigger an offer; in any event, in most public companies, a shareholding very much smaller than 25% can block a special resolution, because of the failure by large numbers of shareholders to vote. There were also suggestions that 20% might be an appropriate level, on the basis that this carried some ability to influence the management of the company. But this is not control in the sense described above. In the light of the overall view of the CBI that the figure should not be lowered, it

was not thought right, in view of the Panel's role as discussed above, that the percentage should be lowered merely in order to discourage predators from building up large shareholdings in companies without making a bid.

Finally, it was argued by some that the mandatory bid threshold should be lowered so that an offeror starting with the maximum holding permissible without making a mandatory bid (currently 29.9%) would have to acquire more than a further 20% or so of the offeree company before declaring the offer unconditional. But the evidence that a holder of 29.9% has a significantly better chance of obtaining 50% than one starting from a lower point is not overwhelming and, moreover, the majority of offers, even hostile ones, are started from much lower platforms than 29.9%.

As a result, the Panel concluded that 30% is the right figure. It has stood the test of time. The Panel does not believe that the level at which control is exercised has changed and, therefore, it rejects suggestions that the 30% level should be lowered.

(ii) Would any form of suspension of listing be appropriate at any stage in a takeover?

There is an argument that a ban on dealings during an offer in relevant companies' shares would be appropriate, so that the offer would be decided solely on the basis of acceptances and so that manipulation of the offeror's share price could be prevented. Such a ban would be regarded by the Panel as an unreasonable fetter on market activity and unfair on shareholders, who might be locked into their investment for a period of months. However, the Panel accepted that some inequality of treatment existed at present in the case

of share exchange offers because Rule 11 permits an offeror during the offer period and within 12 months prior to its commencement to acquire in the market up to 15% of an offeree company's share capital without having to make a cash alternative available as part of its general offer. The Panel has, therefore, decided to reduce to 10% the level of cash purchases permitted by Rule 11. This change has immediate effect, subject to the fact that if an offeror and any person acting in concert with it hold at the date of this Statement 10% or more, but less than 15%, of the voting rights currently exercisable at a class meeting of any class, Rule 11 shall not be regarded as having been triggered provided the holding is not increased after such date.

(iii) Does the current relationship between first closing dates and OFT decisions create unfair or false markets?

Under Rule 5 a unilateral offeror may only acquire 30% or more of the offeree company by buying shares in the market following the first closing date. When an offer comes within the statutory provisions for possible reference to the Monopolies and Mergers Commission, the Secretary of State indicates, if possible by the first closing date, whether he proposes to make a reference, in which event, of course, the offer automatically lapses. However, when the Secretary of State has not so indicated, the offeror can be assisted by the resulting uncertainty in increasing its holding to strategically significant levels.

Accordingly, the Panel has decided that Rule 5 should be amended, so that, in those cases where the statutory provisions apply, a unilateral offeror can only acquire 30% or more of the offeree company once the Secretary of

State's decision is known, if this is later than the first closing date. The Rule is also amended to include provision for competing offers. The Panel will be able to permit the amendment of the offer timetable at its discretion if the Secretary of State's decision is significantly delayed.

(iv) Should unsuccessful offerors be liable for any part of the offeree company's costs?

The CBI has considered whether or not some such scheme would be appropriate, having formed the tentative view that it might be in the case of small offeree companies. The CBI is continuing to collate the opinions of its members on this and the Panel is ready to discuss the matter further if the CBI so desires. Nevertheless, the practical difficulties of such a scheme have to be recognised.

(v) Should the speed of acquisition of up to 29.9% of a company's share capital be slowed down?

The Substantial Acquisition Rules ("SAR's") provide a delaying mechanism for the way in which people can acquire up to 29.9% of a company. These Rules were originally designed to regulate dawn raids, which were not extended to non-professional shareholders and which were perceived as preventing management from advising their shareholders before it was too late to influence the course of events.

Proposals in the Companies Bill will, if enacted, reduce the existing disclosure requirements from 5% within 5 business days of acquisition to 3% within 2 business days. Although this change will not entirely eliminate the problems associated with the undisclosed

acquisition of substantial interests in companies, it is perceived as reducing some of the concern expressed about this issue.

Consideration was nevertheless given to the possibility of changing the existing percentage levels or time limits in the SAR's in order further to slow down the time within which acquisitions of substantial blocks of shares can be made. Consideration was also given to preventing shareholders from increasing their stakes above certain limits pending full disclosure of their current shareholding position. It was, however, felt that limited changes would serve little further purpose and that more drastic changes would represent inappropriate constraints on market activities. In particular, the effect of the existing exemption under the SAR's permitting an acquisition of any number of shares from a single shareholder, if it is the only such acquisition within any period of 7 days, was considered to be a serious restriction on any proposal for change. It was, moreover, not thought to be practicable to remove the single shareholder exemption, because of the need to enable a shareholder to dispose of his shares as a single block and thereby realise the true value of his holding.

(vi) Should there be a requirement for a statement of intention by a 5% shareholder?

The Panel felt that it would be difficult to require any statement of intention which would not be either misleading or meaningless. Statements of intention are required in the United States, where it has been said that the crucial information which the market needs is simply the identity of the acquirer. From that piece of

information the market can, in many cases, infer the plans of the acquirer for the target company. The requirement for the acquirer to state its intentions has merely led to what are frequently little more than standard statements containing a long list of options open to the acquirer. Moreover, if the purchaser of shares has no track record as an offeror and little capital, the market is likely to discount suggestions of aggressive intent. Thus, objective experience of the purchaser's reputation and credibility may well be more meaningful than subjective assertions of intent. The Panel considers that a general obligation to make such statements would not be appropriate, particularly in view of the fact that Rule 2 already requires clarificatory statements, in certain circumstances, when speculation about bid activity is affecting the market.

(vii) Should there be other restrictions on companies being "put into play"?

It is difficult to see what restrictions in the Code could have any effect on companies being "put into play". The mere presence on the share register of certain people, however small the shareholding, is enough, once it is publicly known, to put that company "into play".

It was, therefore, considered that any further restrictions, such as additional limitations on the permitted percentage of ownership of shares within certain time frames, would risk restricting the market and might have the effect of conferring indirect benefits on operators in the market without necessarily improving the position of offeree companies or their shareholders. It was noted that the CBI did not wish to pursue this idea. It was also noted that an inevitable

consequence of access to the public securities markets was that anyone could acquire shares in the company concerned.

(viii) Should there be any further restrictions on short sales other than those currently applied at the end of a takeover period?

The practice of selling shares which a seller does not own at the time is closely associated with the obligations of market-makers to deal at their quoted prices and the operation of the present Stock Exchange account system. The existence of this practice is an essential feature of market liquidity. The introduction of restrictions designed to inhibit the practice generally would, therefore, have serious implications for the operation of the market.

Short selling could have a seriously distorting effect on the accuracy of the counting of acceptances during an offer, particularly towards the end of the offer. However the Code already covers this point in its administrative provisions regarding the counting of acceptances. The Panel therefore does not believe it is necessary, or desirable, for it to seek to restrict what is a normal market activity at other times.

(ix) Should offerors be required to issue a detailed prospectus setting out plans for the development, of the target company?

The Panel considered that further mandatory provisions in the Code to require an offeror to give more detailed plans of its intentions were not desirable. General Principle 4 requires that shareholders are given sufficient information to enable them to reach a

properly informed decision and that no relevant information should be withheld from them. Rule 24.1 then requires an offeror to explain its intentions regarding the offeree company and the employees of the offeree company. In addition, the Panel places considerable weight on the responsibility statements made by boards of directors with regard to the contents of documents, and the general duty of financial advisers to ensure that documents comply with the standards of the Code. For these reasons, it was felt that the Code already went as far as was practicable in this regard. However, the Panel did not dissent from the CBI's view that offerors should give further information, where possible, on a voluntary basis.

(x) Should a company be able to offer a "golden share" to its pension fund or any other body?

This was felt to be a matter for companies and their shareholders to decide, although the Panel noted the dislike of institutional shareholders and others for capital structures which distributed votes disproportionately to the equity.

(xi) Should shares be disenfranchised if full beneficial ownership is not disclosed?

The Companies Act procedures, together with the provisions which The Stock Exchange permits listed companies to incorporate into their Articles of Association, already enable companies to seek disenfranchisement if full details are not disclosed, although the effectiveness of the Companies Act procedures can be severely curtailed if there are large numbers, or several tiers, of nominee companies involved. Since it regards the principle of full

disclosure of beneficial ownership as desirable, the Panel welcomes the recent improvements in this area. The Panel would also support any move by the Department of Trade and Industry to produce a draft notice relating to Section 212, with a view to assisting companies to take full advantage of the statutory procedures which are already available to them.

(xii) Should a two-thirds majority of offeree company shareholders be required for an offer to become unconditional as to acceptances?

The Panel considered that any such suggestion would run counter to the present legal definition of control, in particular to the level required to change the management of a company. The suggestion would, therefore, lead to undesirable anomalies.

(xiii) Should unsuccessful offerors be obliged to sell down to the threshold limit?

It is a fact that an unsuccessful offeror which has bought shares in the market may be left with a shareholding in excess of the present limit for making a mandatory offer. It is not easy to see what can be done about this. Any requirement for a sell down would amount to a very serious penalty on an unsuccessful offeror; the prospect of a large seller could also work to the disadvantage of offeree company shareholders and might even have the perverse effect of encouraging acceptances. The proposal was rejected.

(xiv) <u>Should the one year period before an unsuccessful offeror may offer again be extended?</u>

The Panel was not convinced that there was any general desire for this change and considered that the present period was a reasonable balance between the respective interests of offeree companies, their shareholders and offerors.

4. CODE AMENDMENTS

The Appendix attached to this statement contains details of the amendments to Rules 5.2 and 11.1. These changes come into effect immediately. New pages for the Code to encompass these and a number of other changes will be issued shortly.

26 June 1989

APPENDIX: AMENDMENTS TO THE TAKEOVER CODE CONSEQUENT ON THE REPORT OF THE PANEL WORKING PARTY ON TAKEOVER RULES AND PRACTICES.

1. RULES 5.2(c) (iii) and 31.6

(a) Substitute the following text in place of the current Rule 5.2(c) (iii):-

"(iii) either (A) the first closing date of that offer has passed and the Secretary of State has announced that such offer is not to be referred to the Monopolies and Mergers Commission or such offer does not come within the statutory provisions for possible reference or (B) the first closing date of any competing offer has passed and either the Secretary of State has announced that such competing offer is not to be referred to the Monopolies and Mergers Commission or such competing offer does not come within the statutory provisions for possible reference; or"

(b) The following Note should be added as Note 4 on Rule 31.6:-

"4. References to the Monopolies and Mergers Commission

The Panel may use its discretion to permit an amendment to the offer timetable if the Secretary of State's decision on whether or not to refer an offer is significantly delayed."

2. RULE 11.l(a)

(a) "10%" should be substituted for "15%" in Rule 11.1(a) and in Notes 3 and 4 on that Rule.

(b) The following Note should be added as Note 10 on Rule 11.1:-

"10. Transitional arrangements

If shares of any class under offer in the offeree company, which have been purchased for cash (but see Note 5 on Rule 11.1) 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, but less than 15%, of the voting rights currently exercisable at a class meeting of that class, Rule 11 shall not be regarded as having been triggered if the new limit was not exceeded or any relevant holding was not increased after the time that this amendment to Rule 11.1 came into force."

26 June 1989