THE TAKEOVER PANEL

2002 ANNUAL REPORT

The Panel's 2002 Annual Report was published today. Attached are extracts from the Report by the Director General contained in the Annual Report, in which the following topics are addressed.

- Market abuse regime
- Proposed takeover directive
- Stockbroking relationships and conflicts of interest for offeree advisers
- Information to independent directors in management buy-outs
- Re-registering as a private company
- Cash confirmation

The Annual Report can be found on the Panel's website: www.thetakeoverpanel.org.uk

18 July 2002

MARKET ABUSE REGIME

The new market abuse regime finally came into force in the UK at the beginning of December. In preparation for this, and to counter potential problems arising from regulatory overlap between the FSA and the Panel, we have agreed with the FSA an effective set of operating arrangements which are a matter of public record. They stress the desirability of avoiding undue duplication of work between the Panel and the FSA, and the need for the Panel and the FSA to maintain a close working relationship to deal with issues of potential market abuse which may arise in the context of takeovers.

Early signs of how this works in practice are extremely encouraging. We share common views as to what activity is abusive and there is a good understanding of how each body implements its policies in practice. The Executive and the FSA keep each other fully informed of relevant issues to ensure that unpleasant surprises are minimised.

No sooner has the City started to come to terms with the effects of the Financial Services and Markets Act than it is likely to be changed by the impact of a Market Abuse Directive. This is currently under discussion in Brussels but it is in advanced form and may be implemented as early as 2004. We have had a number of significant concerns about the Directive but are broadly happy with the current position. It should allow for the current interrelationship between the FSA and the Panel to continue, and for Member States to have in place additional measures to protect shareholders' interests in the context of a takeover without running the risk of falling foul of the Directive. However, from a wider City perspective, there are still several unsatisfactory elements to the Directive: the key definition of market manipulation has, for example, been drafted so widely as potentially to create great uncertainty about what forms of behaviour will be regarded as abusive under the Directive, and it is as yet unclear whether certain defences to insider dealing which are currently available under UK legislation will continue to be so.

PROPOSED TAKEOVER DIRECTIVE

Some 12 years after discussions began, in July 2001 the European Parliament failed by one vote to adopt the compromise position on the Takeover Directive which had been forged through the conciliation procedure.

It is likely that the European Commission will bring back a new proposal shortly: the Directive, albeit unambitious in the degree of harmonisation it would achieve, is considered to be an important strand of the Financial Services Action Plan designed to bring about a single market in financial services in Europe. The new proposal is likely to be closely based on the compromise position but altered to take account of the concerns which resulted in its failure last year.

In order to assist the development of a revised proposal, the Commission appointed a committee of company law experts to report on three issues: the existence of a level playing field within Europe, the method for determining the equitable price at which mandatory bids must be made and a harmonised procedure for squeezing out minority shareholders. The committee issued its report in January. Whilst its proposals on equitable price and squeeze out may not prove contentious, and are consistent with UK law and takeover regulation, it is understood that there are objections in several Member States to the proposed "break-through" rule.

This rule would allow the bidder to break-through mechanisms and structures which might frustrate a bid after completion of a takeover offer for all the risk-bearing shares of the company. A bidder who has reached a threshold, to be set at a level no higher than 75 per cent. of the risk-bearing capital of the company, would have the right to exercise voting rights in proportion to his holding of such capital and any provisions in the articles of association to the contrary would be overridden. This rule would have a major impact on bids for companies with classes of share capital carrying differential voting rights.

On this issue it is difficult to see what proposal the Commission can make which will satisfy the widely varying views within the European Parliament and the Member States. From the Panel's perspective, any such provision must be drafted clearly so that

a bidder knows at the outset of a bid what constitutes risk-bearing capital and what compensation, if any, is payable. Otherwise, it will have the opposite effect to that intended, in acting as a barrier to takeovers. In addition, there must be no dilution of the provisions in the failed Directive relating to the restrictions on boards taking frustrating action.

STOCKBROKING RELATIONSHIPS AND CONFLICTS OF INTEREST FOR OFFEREE ADVISERS

Rule 3.1 requires the board of an offeree company to obtain competent independent advice on any offer and to make the substance of such advice known to offeree shareholders. This is a long-standing and fundamental Code requirement.

Financial advisers within groups which have an advisory relationship with an offeror are not normally regarded as appropriate persons to give advice to the offeree board on an offer. In this context, broking relationships with an offeror are considered in the same light as other types of advisory relationship. Whilst it is accepted that the strength and nature of broking relationships, and the services provided under them, vary widely, such relationships generally create a potential conflict of interest.

In one or two recent cases, groups have assumed that a potential conflict of interest arising from an offeror broking relationship can be addressed satisfactorily by the broker standing down from its role for the duration of the offer. The Executive's view is that this action will not normally be sufficient to resolve concerns as to independence. Therefore, in cases where an offeree adviser's group has an offeror broking relationship, the Executive should be consulted at an early stage.

INFORMATION TO INDEPENDENT DIRECTORS IN MANAGEMENT BUY-OUTS

Rule 20.3 requires that all information on the offeree company passed by the management team to external providers of finance, which will include the private equity investor itself, must on request be promptly supplied to the independent directors of the offeree company (or their advisers). The purpose of the Rule is to ensure that the

independent board and Rule 3 adviser have the same information as the providers of finance for the offer when assessing the merits of the offer relative to the value of the company.

The information passable pursuant to Rule 20.3 includes not only information generated by the offeree company but also information on the offeree company developed by or with the assistance of management for the purpose of the transaction. A business model, for instance, prepared by the private equity house will normally include the management team's opinions, estimates and projections based on the team's knowledge of the offeree company, its business and the markets in which it operates and will accordingly be disclosable in its entirety. Similarly, due diligence reports prepared by professional advisers (e.g. accountants, lawyers and property consultants) are likely to be disclosable under Rule 20.3, since they will be derived from information supplied by the offeree company, reviewed by the management team for accuracy and shown to the financiers. The Executive should be consulted in cases of doubt.

RE-REGISTERING AS A PRIVATE COMPANY

In determining whether or not the Code applies, it is the nature of the company which is the offeree or potential offeree company that is relevant. Sometimes, it is decided to re-register a public company as a private company, with the result that the Code does not then apply to that company provided it does not fall within one of the categories described in section 4(a)(i)-(iv) of the Introduction to the Code.

In order to re-register as a private company, it will be necessary as a matter of company law for the company to pass an appropriate resolution at a general meeting. The Executive would expect that the circular convening such general meeting should explain that one of the consequences of re-registration would be to take the company outside the ambit of the Code. The Executive should be consulted in advance so as to ensure that the circular contains an explanation of the Code and the implications for shareholders of re-registration.

CASH CONFIRMATION

Rule 24.7 requires that, when an offer is for cash or includes an element of cash, the offer document must include confirmation by an appropriate third party that resources are available to the offeror sufficient to satisfy full acceptance of the offer. If the party confirming that resources are available fails to act responsibly and to take all reasonable steps to assure itself that the cash is available, it may be required to produce the cash itself.

In some cases, the Executive has been asked whether the cash confirmation required by this Rule could be given by another member of the same group as the offeror, or by a party which is in the same group as one of the members of a consortium that is making the offer. The Executive will not generally regard such a person as an appropriate third party to give the cash confirmation. However, the Executive may be prepared to grant dispensations in appropriate circumstances and should, accordingly, be consulted in such cases.