PCP 11 Issued on 26 April 2002

THE PANEL ON TAKEOVERS AND MERGERS

CONSULTATION PAPER ISSUED BY THE CODE COMMITTEE OF THE PANEL

DUAL LISTED COMPANY TRANSACTIONS AND FRUSTRATING ACTION

REVISION PROPOSALS RELATING TO THE DEFINITION OF AN OFFER AND RULE 21.2 OF THE TAKEOVER CODE

Before it introduces or amends any Rules of the Takeover Code or the Rules Governing the Substantial Acquisitions of Shares, the Code Committee of the Takeover Panel is required under its consultation procedures to publish the proposed Rules and amendments for public consultation and to consider responses arising from the public consultation process.

The Code Committee is therefore inviting comments on this Consultation Paper. Comments should reach the Code Committee by 28 June 2002.

Comments may be sent by email to:

consultation@disclosure.org.uk

Alternatively, please send comments in writing to:

The Secretary to the Code Committee
The Panel on Takeovers and Mergers
P.O. Box No. 226
The Stock Exchange Building
London
EC2P 2JX

Telephone: 020 7382 9026
Fax: 020 7638 1554

It is the Code Committee's policy to make all responses to formal consultation available for public inspection unless the respondent requests otherwise.

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1. INTRODUCTION

1.1 On 11 March 2002, the Code Committee announced that it had come to a preliminary conclusion that the City Code on Takeovers and Mergers (the "Code") should be amended to bring the establishment of dual listed company ("DLC") structures within the Code. This announcement was made following recommendations by the Panel Executive in the light of its recent experience in regulating the offer by Carnival Corporation for P&O Princess plc in the face of a proposed DLC merger with Royal Caribbean Cruises Ltd. The purpose of this paper is to seek views on the approach (which includes amendments to the Code) that the Code Committee is proposing in relation to DLC transactions.

1.2 The Code Committee has also considered amending the Code to bring within its scope certain arrangements which could constitute frustrating action in breach of General Principle 7. This paper, therefore, also invites views on the approach and the amendments proposed in relation to such arrangements.

2. BACKGROUND

2.1 What is a DLC?

A DLC structure allows two companies to combine their operations and yet retain a degree of separation, if desired. Generally, this is achieved by retaining the merging companies as separate legal entities but putting in place arrangements to ensure that the group, as a whole, operates as if it were a single enterprise, normally under a unified management structure. The respective shareholders of the merging companies do not transfer or exchange their existing shares in the companies nor do they receive any shares or other consideration as a result of the DLC itself being established. Thus, DLCs can form a basis on which two companies (in different jurisdictions) are combined without certain political, commercial and tax difficulties that can arise when one company takes over another.

2.2 DLC structures may also be used to effect demergers or other corporate reorganisations between a company and its shareholders. The Code Committee is not proposing to amend the Code in order to regulate such transactions.

2.2 Why are DLC structures used?

2.2.1. The reasons for using a DLC to effect a merger will vary according to the circumstances, but in most cases all or some of the following factors will be relevant:

(a) the importance of retaining separate stock exchange listings and inclusion in stock indices;

(b) the reduced risk of flowback (i.e. offeree shareholders selling offeror shares which they have received in an overseas listed company because they are unable or unwilling to hold them) with a depressing effect on the share price of the offeror;

(c) tax considerations for shareholders (e.g. the tax treatment of dividends and the fact that no disposal of shares takes place) and tax considerations for the companies (e.g. tax domicile);

(d) the continued access to capital markets in both home jurisdictions;

(e) the reduced risk of change of control implications arising (e.g. in joint ventures and other key commercial contracts or finance agreements); and

(f) political considerations (e.g. sensitivities to foreign ownership of high profile companies).

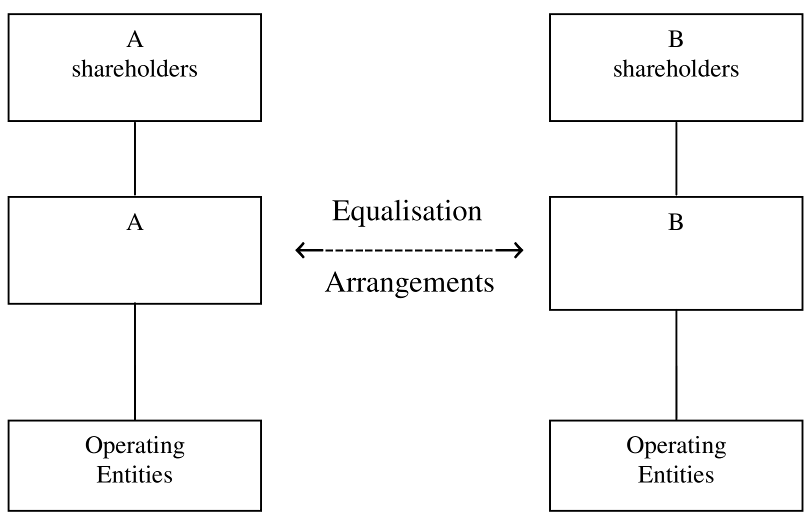
3. COMMON DLC STRUCTURES

3.1 Introduction

3.1.1 There are three basic methods of structuring DLCs. Broadly, these are known as:

- the separate entities structure;
- the twinned share/stapled stock structure; and
- the combined entities structure.

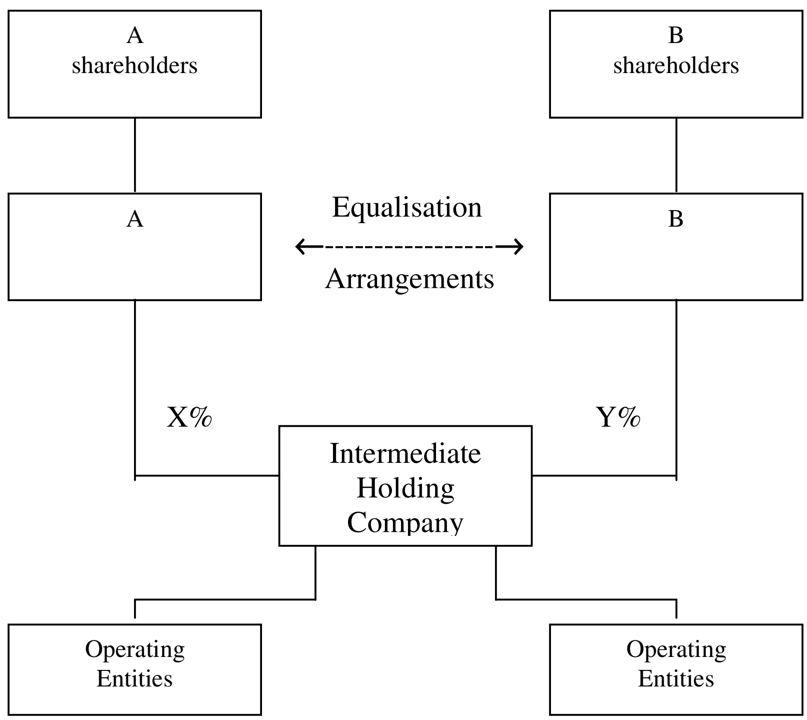
3.2 The separate entities structure



3.2.1 Under a separate entities structure, the merging companies retain their respective domiciles, corporate identities, listings and shareholder bases. They enter into equalisation arrangements which have the effect of ensuring equal treatment in economic and voting terms of the two companies' shareholders. Equalisation payments for shareholders can be achieved by a cross-holding of special dividend access shares or contractual payments.

3.2.2 Recent examples of this structure are the BHP/Billiton and GKN/Brambles DLCs.

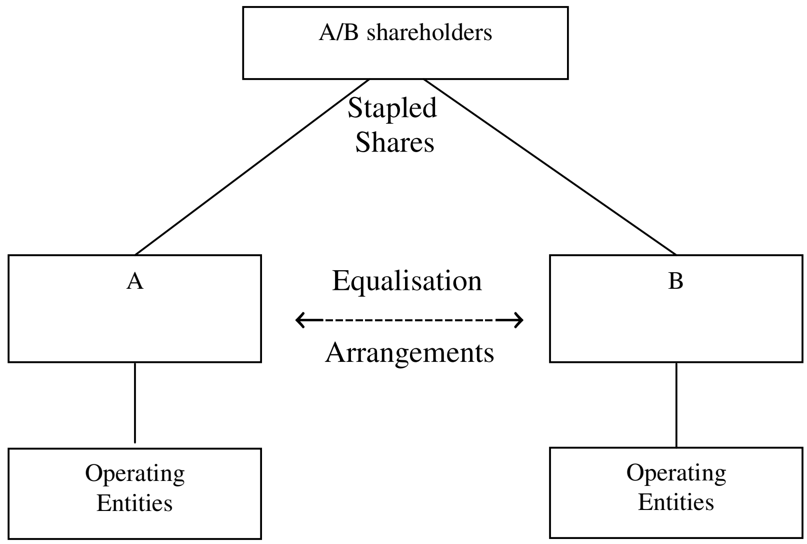
3.3 The combined entities structure



3.3.1 Another method is the combined entities structure. In this case, the merging companies retain their domiciles and corporate entities as before but the assets of the merging companies are held by one or more jointly owned companies; this is more akin to a joint venture arrangement.

3.3.2 An example of this structure is the Reed/Elsevier DLC.

3.4 The stapled stock structure



3.4.1 A variation on these structures which is commonly characterised as a DLC merger is the stapled stock structure. In this structure shares in each of the entities are "twinned" so that they cannot be separately traded. The intention is to avoid the price variance/market discounts arising from shares in each of the companies being traded separately.

3.4.2 Examples of this structure are the formation of Euro Tunnel and the SmithKline Beecham merger.

3.5 Equalisation arrangements

3.5.1 In each of these structures, economic integration is achieved by the two companies entering into equalisation arrangements. The methods by which these are effected will vary according to the particular circumstances and will depend upon the DLC structure that is used. However, in simple terms equalisation arrangements ensure that the rights of shareholders in each of the two DLC companies to income and capital will reflect the respective valuations negotiated in respect of the two companies at the time of the transaction (the "equalisation ratio"). Equalisation enables the companies in a DLC to replicate the economic effect of a merger but without one company's shareholders having to exchange their shares for shares in a foreign listed entity.

3.5.2. A feature of recent separate entities' structures has been the inclusion of a combined voting structure mechanism. This enables the votes of shareholders in one company to be directly reflected in a shareholder meeting of the other company on a see-through basis. This is effected, in practice, by both companies convening shareholder meetings at which identical resolutions are proposed and voted on by way of a poll. A special purpose vehicle in each parent holds a special voting share which carries the same number of votes as are cast for and against the equivalent resolution at the other parent's shareholder meeting. The votes cast by the special voting share can also be weighted in accordance with the equalisation ratio.

4. THE PANEL'S CURRENT APPROACH TO DLC TRANSACTIONS

4.1 The creation of a DLC

4.1.1 The basic premise to date has been that DLC transactions are not subject to the Code since they do not involve a change of control in the relevant Code company. This was agreed by the Panel at its Quarterly Meeting in July 2001 and the conclusion was set out in the 2001 Annual Report. In a DLC transaction, no person, or persons acting in concert with the proposed DLC partner, normally comes to hold more than 30% of the voting rights of the Code company as a result of the transaction. Also, shareholders of the Code company have no choice to make as to whether they should retain or dispose of their shares, as would be usual in a conventional offer. In essence, therefore, a DLC transaction involves the dilution of voting rights rather than a change of control in Code terms.

4.1.2 Although the Code does not normally apply to DLC structures, parties and their advisers proposing to implement a DLC structure involving a company to which the Code applies are nonetheless expected to consult the Panel at the earliest opportunity.

4.2 Ongoing regulation of Code company that has entered into a DLC

4.2.1 Whilst a DLC transaction itself may not be a Code transaction, a Code company which has entered into such a transaction remains subject to the Code thereafter, assuming it continues to be resident for Code purposes.

4.2.2 If, therefore, an offer is subsequently made for the Code company, then the Code will apply. Further, if two companies combine using a DLC transaction, but later decide to unwind the DLC arrangements, for example by the non-Code company effecting a conventional securities exchange offer for the Code company, then that offer would be a Code transaction.

4.2.3 A detailed analysis of the application of the Code where a subsequent offer is made for a Code company which forms part of a DLC structure is beyond the scope of this paper. Clearly, where such structures have incorporated a combined voting mechanism, issues arise in relation to the application of the mandatory bid threshold and the price-based Rules. In such circumstances, the Panel would normally conclude that the trigger for a mandatory bid for the Code company should be by reference to the acquisition of voting rights calculable on the basis of the voting rights of the combined companies. As a direct consequence of this conclusion, the logical application of Rule 10 to determine the success or otherwise of an offer would normally also be based on a combined voting test. The price-based Rules, specifically Rules 6, 9 and 11, would normally take into account acquisitions of shares in either company and hence be relevant to any offer for the Code company.

4.2.4 It is worth noting that, in many cases, the strict application of Rule 9 on an aggregate voting basis will not arise since, in order to ensure that the two companies operate as a single combined group, amendments are often made to their constitutions. These amendments ensure that a person cannot obtain control of one of the companies without having to make an equivalent offer to the shareholders of the other. For example, in BHP/Billiton, the constitutional changes introduced at the time of the DLC transaction require a mandatory bid to be made for both companies by any person who exceeds a voting power threshold of 20% in relation to BHP and 30% in relation to Billiton, on a "stand alone" basis. These percentages reflect the different mandatory bid thresholds in the Australian and UK regulatory regimes. If a person exceeds these limits without making equivalent offers for both companies, sanctions are imposed, including withholding of dividends, restricting voting rights and compulsory divestment of shares in respect of those shares in excess of the relevant threshold.

4.2.5 The Code Committee is not proposing any amendments to the Code which would result in the Panel having to change its approach to the ongoing regulation of transactions involving a Code company which has entered into a DLC structure.

5. CONSIDERATIONS REGARDING A POSSIBLE CHANGE OF APPROACH

5.1 There is an argument that DLC transactions should be regarded as Code transactions on the grounds that, whilst not involving a technical change of control in Code terms, they are a means of effecting a merger which would otherwise be structured as a Code offer. That argument is all the stronger when an offer which is subject to the Code is or is likely to be made in competition with a DLC transaction. Offeree shareholders' interests may be prejudiced if there is no equality of treatment between the two transactions (see paragraph 5.4 below).

5.2 In fact, DLC transactions have not generally presented any Code problems unless a competing offer has been announced for the Code company. It is important to note that, even though DLC transactions currently fall outside the Code, the Code company shareholders are not without information or protection. DLC transactions have hitherto tended to be between large listed companies. As such, the Code company would, by virtue of its UK listing, be subject to the FSA Listing Rules. Similarly, the non-Code company would normally be subject to equivalent regulation by its domestic regulator. Furthermore, DLC transactions, in most cases, must be approved by a special resolution of the shareholders concerned.

5.3 However, the fact that DLC transactions fall outside the Code means that certain protections offered by the Code and designed to ensure, in the context of a change of control, that all shareholders are treated fairly and equally and that there is an orderly framework for the transaction, are not present.

5.4 DLC transaction in competition with a Code offer

5.4.1 The following Rules are those which would or might be particularly pertinent when a DLC transaction is competing with a Code offer and which would not at present apply to the DLC transaction:

(a) price-based rules (Rules 6, 9 and 11): share purchases have certain implications for the structure and price of an offer. DLC transactions do not, in fact, generally involve acquisitions by one company of shares in the other;

(b) dealing disclosure rules (Rules 8 and 38): these provide market transparency by alerting the market to dealings in the offeree company and, where a securities exchange offer is proposed, the offeror;

(c) conditions to an offer (Rule 13): this prevents the use of subjective conditions to an offer and regulates the circumstances in which an offer condition may be invoked;

(d) special deals (Rule 16): this prohibits special deals between the offeror and shareholders in the offeree;

(e) merger benefits statements (Rule 19.1, Note 8): in a recommended securities exchange offer, where a competing offer is made and a merger benefits statement is subsequently repeated, that statement is required to be reported upon by financial advisers and accountants;

(f) equality of information (Rule 20): Rule 20.1 provides that information should be made equally available to all shareholders at the same time and in the same manner. In particular, it governs the policing of meetings (Note 3) and the issue of associated parties' analysts' research (Note 4). Rule 20.2 provides that information given to an offeror must be given to any other offeror or bona fide potential offeror, even if that other offeror or potential offeror is less welcome;

(g) profit forecasts (Rule 28) and asset valuations (Rule 29): these set out detailed requirements for the production of profit forecasts and asset valuations, and for the reporting thereon; and

(h) frustrating action (Rule 21): this rule is discussed in detail in section 9 below. In essence, however, Rule 21.1 *is* applicable regardless of whether a DLC transaction is classified as a Code transaction. By contrast, Rule 21.2, which places limitations on the size of inducement fees, currently applies only to arrangements entered into in conjunction with Code transactions.

5.5 Other merger structures involving Code and non-Code companies

5.5.1 The Code Committee has considered the treatment under the Code of other types of business combinations. There are three principal ways in which a merger might be effected on an all share basis between a Code company and a non-Code company:

Structure A: acquisition of the Code company by the non-Code company;

Structure B: acquisition of the non-Code company by the Code company; and

Structure C: acquisition of the Code company and the non-Code company by a Newco.

In each case, the transaction might be effected by way of:

(a) a takeover offer or, under Structure C, parallel and inter-conditional takeover offers; or

(b) a scheme of arrangement or, under Structure C, parallel and inter-conditional schemes of arrangement (or the equivalent means of effecting such structures under the law of the jurisdiction of incorporation of the non-Code company).

5.5.2 Each of Structures A, B and C achieves the same result in that, following completion of the merger, the register of members of the new holding company will in each case be identical. However, the extent to which the Code applies to the transaction will not be the same in each case. For example, whilst the Code will always apply to a merger implemented using Structure A, it will not apply to a merger implemented using Structure B, unless as a result of the merger a single entity or group of parties acting in concert comes to hold 30% or more of the Code company.

5.5.3 The extent to which the Code will apply to a merger implemented by means of Structure C will depend upon the facts of the case. Generally speaking, the Code will apply in full to the offer by the Newco for the Code company or, where relevant, to the scheme of arrangement entered into by the Code company.

5.5.4 There may, however, be cases where there is no doubt that the substance of the transaction is the acquisition by a Code company of a non-Code company, albeit that it is implemented by means of Structure C. In such circumstances, the Panel may be willing to agree that the Code should not apply to the offer for the Code company. Factors which the Panel will take into account in looking at this issue will include the following:

(a) the percentages of the issued share capital of the Newco which will be held by the former shareholders of the Code company and by the former shareholders of the non-Code company following completion of the transaction. The greater the proportion of shares in the Newco which will be held by the former shareholders of the Code company, the greater the likelihood that the Panel will grant a dispensation;

(b) the composition of the board of the Newco following completion of the merger and the location of the company's central management and head office;

(c) the proposed structure of the transaction. For example, the Panel will be more inclined to grant a dispensation where the transaction is to be implemented by means of a scheme of arrangement carried out under Section 425 of the Companies Act 1985 as this will be approved by the High Court.

5.5.5 If the Code were to be amended to bring DLC transactions within its jurisdiction, the Code Committee considers that the Code should apply as if Structure C were being adopted. Accordingly, the Panel would be able to grant dispensations from its application in appropriate cases by reference to, inter alia, the factors set out in paragraph 5.5.4 above.

Q1 Do you agree that DLC transactions should be subject to the Code?

5.5 There are two possible ways of bringing DLC transactions within the Code:

- to apply the Code only when there is a competing Code offer (Option One); and
- to apply the Code to DLCs from the start (Option Two).

The way in which each option would operate is explained below.

6. OPTION ONE: APPLY THE CODE ONLY WHEN THERE IS A COMPETING OFFER

6.1.1 Given that DLC transactions do not generally present any Code problems unless a competing proposal emerges, under Option One, the Code would apply once the Code company is aware of the existence of a potential competing offeror.

6.1.2 This would be analogous to the way in which the Code treats unitisation proposals. In a unitisation, shareholders in an investment trust are asked to vote on the winding up of the trust and for the transfer of its assets into one or more new unit trusts, under either new management or the existing management. This in itself is not regarded as a Code transaction. If, however, a third party offeror or possible offeror emerges in competition with such a proposal, the Code is then applied to both transactions (with certain modifications).

6.1.3 The Panel would continue to be consulted in advance whenever DLC transactions are proposed. This is, of course, necessary because the application of the Code in the event of a competing offer needs to be discussed (see paragraph 6.3 below). In addition, as explained in paragraph 5.5.5 above, the Code Committee considers that the Panel should be able to grant dispensations from the Code in appropriate circumstances.

6.1.4 The proposed Code amendments which would be required to implement Option One are set out at Appendix A.

6.2 Arguments for and against Option One

6.2.1 Arguments for

(a) This approach would be a refinement of the existing approach. It recognises that DLC transactions do not technically involve a change of control and yet addresses the principal concerns identified in paragraph 5.4 above as regards issues that arise where a Code offer is in competition with a DLC.

(b) This approach recognises that the Code is not generally relevant to DLC transactions. It is principally upon a competing bid emerging that Code Rules become of relevance and even then it is arguably a limited number.

6.2.2 Arguments against

(a) If one takes the view that a DLC transaction is one which, if it had been effected in the standard way (i.e. a securities exchange offer), would be covered by the Code, then offeree shareholders should not be deprived of Code protection from the start simply because of the form of the transaction.

(b) If it is accepted that the Code is applicable from the time a competing offer emerges, then there may be difficult judgements to make regarding whether there should be retrospective application of the Code rules and, if so, which ones.

6.3 Application of the Code under Option One

6.3.1 Once a competing proposal arose such that the start of the offer period was triggered, the DLC transaction would be treated as a securities exchange offer under the Code. The Code company would be treated as the offeree as under Structure C above.

6.3.2 The application of the Code in the period between the announcement of the DLC transaction and the date from which it is considered to be a Code transaction, would be kept to a minimum. The application of the key rules identified in paragraph 5.4.1 above is set out below:

(a) The price-based Rules 6, 9 and 11 would be relevant to the extent that acquisitions of shares were made after the announcement of the existence of the potential competing offeror. Acquisitions of shares before that time would not be relevant for Code purposes unless the DLC is restructured to compete with the competing offer;

(b) The rules governing dealing disclosures (Rules 8 and 38), policing of meetings and issue of analysts' research (Rule 20.1) would all apply from the time the DLC transaction becomes a Code transaction;

(c) Rule 13 covering subjective conditions would apply from the time when the DLC transaction becomes a Code transaction, but with retrospective effect. Accordingly, the parties to the DLC transaction would need to be aware that although there would be no requirement for the conditions to the implementation of the DLC to be drafted in compliance with Rule 13, in the event that a competing Code transaction emerged, any such conditions could only be invoked with the consent of the Panel. The Panel would not allow conditions to be invoked at the subjective discretion of the directors and would apply the materiality test set out in Note 2 on Rule 13;

(d) Rule 16 covering special deals would apply from the time when the DLC transaction becomes a Code transaction, but with retrospective effect. Accordingly, the parties to the DLC transaction would need to be aware that no such special deals should be entered into in connection with the DLC transaction unless they are capable of being unwound or blessed under either Note 2 or Note 4 on Rule 16 by an adviser's fairness opinion and, if appropriate, independent shareholders' approval. Such approval could be obtained either once the competing proposal had emerged or at the time of the DLC transaction;

(e) Profit forecasts, asset valuations and merger benefits statements made in connection with the DLC transaction may need to be reported on following the announcement of the existence of the potential competing offeror, under the normal Code rules, once the DLC transaction becomes a Code transaction (even if made before the start of the offer period);

(f) Rule 20.2 would apply retrospectively. Any information given by the Code company to its prospective DLC partner would have to be provided to the competing offeror, unless the non-Code company shareholders ended up with less than 50% of the enlarged group under the DLC terms. This is consistent with the application of Rule 20.2 in securities exchange offers implemented by means of Structure C;

(g) Rule 21.1 would apply from the time that the Code company became aware that a bona fide competing offer might be imminent (i.e. in the usual way); and

(h) following the change being recommended by the Code Committee (see Section 9), Rule 21.2 would apply to inducement fees arranged in connection with both Code and DLC transactions.

7. OPTION TWO: APPLY THE CODE FROM THE START

7.1.1 Under Option Two, the Code would be amended to make it clear that DLCs would be treated as Code transactions from the start.

7.1.2 In this case, the Code would apply to the DLC transaction, with suitable modifications. This would be analogous to the way in which the Code treats Court approved schemes of arrangement implemented under Section 425 of the Companies Act 1985. For example, under a scheme of arrangement, the timetable for the transaction is fixed by the Court. Accordingly, Code Rules relating to timing are applied in a flexible manner by the Panel.

7.1.3 The proposed Code amendments which would be required to implement Option Two are set out at Appendix B.

7.2 Arguments for and against Option Two

7.2.1 Arguments for

(a) The change is clear and straightforward;

(b) It avoids the problem associated with Option One of applying some rules from the time the DLC is proposed, other rules with retrospective application when the competing offer emerges and the rest only from that time onwards.

7.2.2 Arguments against

(a) The position would be inconsistent with the approach that has been taken by the Panel to date and which was arrived at on the basis that there is, in Code terms, no change of control.

(b) Non-contested DLCs would become the subject of more and arguably unnecessary regulation, when there is logically no cause to treat them as Code transactions since there is no change of control.

7.3 Application of the Code under Option Two

7.3.1 The normal Code Rules would apply, with the Code company being treated as the offeree and the offer being regarded as a securities exchange offer. However, certain Rules, principally those relating to the offer timetable and acceptances, would be applied flexibly having regard to the particular circumstances. An overview of the manner in which the Panel is likely to apply certain key Rules in the particular circumstances of a DLC transaction is set out below:

(a) a firm announcement under Rule 2.5 would start the Code timetable. The Code company would be expected to post its circular to shareholders, in order to convene the shareholder meeting to approve the resolutions to give effect to the DLC, within 28 days of the firm announcement under Rule 2.5;

(b) Rules 8 and 38 would apply to dealings in both DLC companies, as appropriate;

(c) although the parties might contractually agree that there will be conditions to completion of the DLC, such conditions would be subject to Rule 13 and in particular Note 2 on Rule 13, should, for example, the non-Code company wish to invoke the conditions and withdraw from the DLC;

(d) the price-based Rules (Rules 6, 9 and 11) would be relevant to the extent the non-Code company acquired shares in the Code company. Such acquisitions could require a cash and/or share alternative to be made available by the non-Code company to shareholders in the Code company. It is difficult to foresee circumstances in which a DLC structure would be compatible with such an alternative. The non-Code company would, therefore, for example, effectively be prevented by Rule 11.1 from buying any shares in the Code company during the course of the DLC transaction;

(e) Rule 10, which sets out the minimum acceptance condition and Appendix 4, which sets out the receiving agents' code of practice for the purpose of counting acceptances, would not apply. The success or failure of the DLC would instead depend upon the passing of resolutions at the relevant shareholder meetings of the merging Code companies; and

(f) as noted in sub-paragraph (a) above, the timing Rules set out in Section M of the Code would be applied according to the circumstances. Withdrawal rights under Rule 34 would not be in point. In any event, shareholders who might have submitted a form of proxy to vote in favour of resolutions being proposed at a shareholders' meeting to approve a DLC would be entitled to attend and vote in person at the meeting itself if they wished to change their vote in the light of a competing offer.

8. RECOMMENDATION BY THE CODE COMMITTEE ON OPTIONS ONE AND TWO

8.1 The Code Committee can see the attractions of Option One. In Code terms, there is normally no change of control in a DLC transaction and, until a competing offer is announced, equality of treatment issues do not emerge. Also, it is arguable that Option Two would represent a degree of over-regulation in circumstances where there is no competing offer.

8.2 However, the Code Committee is concerned that the application of Option One might be impracticable since there might be difficult judgements to make regarding whether there should be retrospective application of the Rules and, if so, of which ones. Although the Code Committee currently considers that it has identified the important issues which would arise in this context, it is difficult to be sure that others might not emerge. Moreover, although there is no technical change of control in a DLC, it is effectively a permanent merger and is viewed as such by shareholders.

8.3 Therefore, on grounds of practicability and prudence, the Code Committee has concluded that it would be better to elect for Option Two and apply the Code to DLC transactions from the start.

Q2 Do you agree that Option Two is preferable to Option One?

Q3 If you prefer Option One, do you agree with the approach being suggested by the Code Committee as regards the application of the Code under Option One?

Q4 If you prefer Option Two, do you agree with the approach being suggested by the Code Committee as regards the application of the Code under Option Two?

9. FRUSTRATING ACTION AND PROPOSED AMENDMENTS TO RULE 21.2

9.1 A fundamental objective of the Code is to prevent boards of companies from taking any action which would frustrate an offer against the wishes of their shareholders. This is encapsulated in General Principle 7 and in various Rules, including, in particular, Rule 21.

9.2 The Panel has never considered it appropriate to attempt to regulate the activities of Code companies outside situations regulated by the Code. This is principally because the Code is designed to ensure good business standards and fairness to shareholders in the context of takeovers, not outside such situations. Also, UK listed companies are subject to the continuing obligations imposed by the Listing Rules and these rules impose practical limitations on what agreements can be entered into by listed companies without shareholder consent. Finally, "poison pills" have not been prevalent in the UK, in part due to the fact that the investment community has generally not looked favourably upon such practices.

9.3 The Code Committee has been looking at the application of Rule 21 to situations where a Code company is in negotiations with a proposed offeror and enters into arrangements which might have the effect of frustrating any other third party from making an offer for the Code company.

9.4 Rule 21.1 includes a list of specific matters that are deemed to constitute frustrating action and which cannot, therefore, be entered into by the offeree company without shareholder consent. Note 1 on Rule 21.1 provides that the requirement to obtain shareholder consent will normally be waived by the Panel if this is acceptable to the offeror. Accordingly, where a Code company (company A) is in discussions with a potential offeror (company B) then it can in theory, but subject always to Rule 21.2, enter into contractual arrangements with company B which might have the effect of frustrating an offer for company A by company C (assuming of course that company A is not aware of company C's interest).

9.5 Arrangements entered into by company A with company B would be subject to Rule 21.2 which, inter alia, sets a limit on the level of inducement fees arranged between an offeror and offeree in a Code transaction. This Rule applies irrespective of the potential existence of a competing offeror. Although Rule 21.2 is principally designed to catch traditional inducement fee arrangements as described in the first paragraph of Note 1 on Rule 21.2, it also applies 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 (see the wording of the second paragraph of Note 1 on Rule 21.2). Accordingly, many arrangements will be caught by the wording of this Note.

9.6 As part of its review of the status of DLC transactions, the Code Committee has concluded that Note 1 on Rule 21.2 should be amended to make clear that the favourable arrangements with an offeror or potential offeror which are referred to in the second paragraph of Note 1 on Rule 21.2 should include, for example, break fees, penalties, put or call options or other provisions which may potentially benefit an offeror, regardless of whether such arrangements are considered to be in the ordinary course of business. Accordingly, if, in the above example, company A and company B entered into a commercial joint venture which enabled company B to acquire company A's interest in the joint venture at a discount in the event of a change of control of company A, then Rule 21.2, as amended, would limit the amount of the discount.

9.7 The Code Committee believes that the restrictions set out in Rule 21.2 should apply where the type of arrangements referred to in paragraph 9.6 above are entered into in connection with a Code offer, as currently defined, or a DLC transaction.

9.8 In summary, the effect of the Code Committee's proposals, if adopted, would be as follows:

(a) Rule 21.1 will remain unchanged. It will continue to restrict the board of a Code company entering into a Code offer (as currently defined), a DLC merger or any other transaction, from taking action which might frustrate a competing offer, so long as it has reason to believe a bona fide offer might be imminent; and

(b) Rule 21.2, as amended, will clarify the nature of the arrangements to which the Rule applies and will extend the scope of the Rule, which sets a limit on the level of inducement fees arranged between the parties in a Code offer (as currently defined), to cover DLC transactions as well.

9.9 The way in which the Code amendments will have to be implemented will depend upon whether Option One or Option Two is adopted in relation to the treatment of DLCs:

(a) If Option One is adopted, the scope of Rule 21.2 should be amended to apply not only to Code transactions but also to DLC transactions, whether or not in competition with a Code offer.

(b) If Option Two is adopted, the scope of Rule 21.2 needs no amendment because a DLC transaction will be a Code transaction.

(c) Whether Option One or Option Two is adopted, the second paragraph of Note 1 on Rule 21.2 requires clarification.

(d) The proposed drafting changes are set out in Appendices A and B.

Q5 Do you agree that Rule 21.2 should be amended as above?

APPENDIX A

1. Definition of Offer

In the second sentence, i) after "**unitisation proposals**" add "**or dual listed company transactions regardless of whether control (as defined) is to be obtained or consolidated**"; and ii) after "**such proposals**" add "**or transactions**".

2. Rule 21.2

In *Note 1*, second paragraph, add:-

> "*Such arrangements will include, for example, break fees, penalties, put or call options or other provisions having similar effects, regardless of whether such arrangements are considered to be in the ordinary course of business. In cases of doubt the Panel should be consulted.*"

Add a new *Note 3* as follows:-

> "*3. Dual listed company transactions*
>
> *This Rule also applies to arrangements entered into in connection with a dual listed company transaction.*"

APPENDIX B

1. Definition of Offer

In the first sentence, i) replace the words "**and also**" appearing after "**Court schemes**" with a comma; and ii) after "**subsidiary**" add "**and dual listed company transactions regardless of whether control (as defined) is to be obtained or consolidated**".

2. Rule 21.2

In *Note 1*, second paragraph, add:

> *"Such arrangements will include, for example, break fees, penalties, put or call options or other provisions having similar effects, regardless of whether such arrangements are considered to be in the ordinary course of business. In cases of doubt the Panel should be consulted."*

APPENDIX C

Questions for Consultation

Q1 **Do you agree that DLC transactions should be subject to the Code?**

Q2 **Do you agree that Option Two is preferable to Option One?**

Q3 **If you prefer Option One do you agree with the approach being suggested by the Code Committee as regards the application of the Code under Option One?**

Q4 **If you prefer Option Two do you agree with the approach being suggested by the Code Committee as regards the application of the Code under Option Two?**

Q5 **Do you agree that Rule 21.2 should be amended as above?**