PCP 2005/1 Issued on 7 January 2005

THE PANEL ON TAKEOVERS AND MERGERS

CONSULTATION PAPER ISSUED BY THE CODE COMMITTEE OF THE PANEL

DEALINGS IN DERIVATIVES AND OPTIONS

OUTLINE PROPOSALS RELATING TO AMENDMENTS PROPOSED TO BE MADE TO THE TAKEOVER CODE AND THE SARS

Before it introduces or amends any Rules of the Takeover Code ("the Code") or the Rules Governing Substantial Acquisitions of Shares ("the SARs"), the Code Committee of the Takeover Panel ("the Code Committee") is normally required under its consultation procedures to publish the proposed Rules and amendments for public consultation and to consider the responses arising from the public consultation process. In this case, the Code Committee is publishing in this Consultation Paper the framework for the proposed amendments with a view to publishing a further Consultation Paper in due course setting out in detail the proposed amendments to the Code and the SARs.

The Code Committee is inviting comments on this Consultation Paper by 28 February 2005.

Comments may be sent by email to:

supportgroup@thetakeoverpanel.org.uk

Alternatively, please send comments in writing to:

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

A. INTRODUCTION

1. Background

1.1 In recent years, there has been a significant increase in the volume of trading in derivatives and options both by parties to an offer (and persons acting in concert with them) and by other market participants. The Code Committee believes that the Code and the SARs need to be amended to take account of this development and has been focussing on the following key areas:

(a) dealings in derivatives and options by parties to an offer and persons acting in concert with them and by persons whose interests, together with those of their concert parties, fall into the 30% to 50% band; and

(b) dealings during offer periods in derivatives and options by market participants (including hedge funds and the proprietary trading desks of investment banks) and dealings by investment banks and securities houses to hedge such positions.

1.2 The Code Committee believes that the issues raised in this Consultation Paper are particularly important and complicated and also have wide ranging implications for a number of organisations. Therefore, in this case, the Code Committee believes, unusually, that it is appropriate to consult first on the outline of its proposals with a view to then consulting on the detailed rule changes in the light of the responses received.

1.3 A number of the issues discussed in this Consultation Paper relate to issues raised in the Consultation Paper on market related issues published by the Code Committee on 17 June 2004 (PCP 2004/3). This paper has been prepared on the basis that the proposals set out in PCP 2004/3 are implemented in full.

1.4 The Code Committee is aware that a number of the proposals set out in both Consultation Papers will, if implemented, necessitate changes to the monitoring

and disclosure systems of investment organisations and securities houses. To assist with the implementation of the necessary system upgrades, the Code Committee will endeavour to coordinate implementation of the relevant amendments to the Code and the SARs. This may mean that certain of the amendments proposed in PCP 2004/3 will be deferred until completion of the consultation exercise on dealings in derivatives and options.

2. Derivatives and contracts for differences

2.1 Under the Code, the term "derivative" is widely defined to include "any financial product whose value in whole or in part is determined directly or indirectly by reference to the price of an underlying security but which does not include the possibility of delivery of such underlying securities". The Note on the definition makes clear that it is intentionally widely drafted to encompass all types of derivative transactions, save where the derivative has no connection with an offer or anticipated offer.

2.2 The most common form of derivative instrument encountered by the Panel is a contract for differences ("CFD") under which the holder of the CFD benefits from a rise (in the case of a long CFD) or fall (in the case of a short CFD) in the price of a company's securities from the reference price agreed at the time that the contract is entered into. The holder of the CFD will suffer a corresponding loss if the share price moves in the opposite direction. The counterparty to such a transaction, which will usually be an investment bank or a securities house, will normally hedge the position to which it becomes exposed as a result of writing the CFD contract and will generally do so by acquiring or selling short (as the case may be) a corresponding number of the underlying securities at around the CFD reference price. When the holder of the CFD closes out the contract, the counterparty will then flatten its position, in the case of a long CFD by selling the shares which it acquired to hedge its position ("the hedge shares"), possibly to the CFD holder, or in the case of a short CFD by purchasing shares to fill its short position, in each case at around the price at which the contract is closed out. In many cases, the closing out price is actually

determined by reference to the price at which the hedge shares are sold or purchased.

3. Justification for the Code and the SARs applying to dealings in derivatives and options

3.1 It may be argued that no consequences should arise under the Code or the SARs from entering into a CFD, since the holder of the CFD has only an economic interest in the movement in the price of the shares to which the CFD is referenced. As a matter of law, title to the hedge shares (in the case of a long CFD) is held by the counterparty and the contractual arrangements between the holder of the CFD and the counterparty usually reflect this.

3.2 However, the holder of a long CFD is able in practice to exercise a significant degree of de facto control over the shares held by the counterparty to hedge its position. The counterparty normally has no economic exposure in respect of the transaction and will naturally wish to obtain repeat business from the holder of the long CFD. As a result, the counterparty will often exercise the voting rights attaching to the hedge shares according to the wishes (or likely wishes) of the long CFD holder. Furthermore, the holder of a long CFD knows that, because the counterparty will not normally wish to be in an unhedged position, the counterparty is unlikely to dispose of the hedge shares until the CFD is closed out. At that moment, the former holder of the long CFD may wish to acquire the hedge shares from the counterparty and, if so, this is likely to suit the counterparty.

3.3 In the light of the above, the Code Committee understands that it is frequently the expectation of a holder of a long CFD that the counterparty will ensure that the shares to which the CFD is referenced are available to be voted by the counterparty and/or sold to the holder of the CFD on closing out the contract. If the counterparty does not hold any such shares (because, for example, its book is balanced by an offsetting short CFD), the holder of the long CFD would normally expect the counterparty to acquire the necessary shares and to act in the manner outlined above, even if that resulted in a cost to the counterparty.

3.4 The Code Committee's understanding as set out above is supported by the conduct of holders of long CFDs in a number of recent cases, including the following:

(a) in the case of BAe Systems' offer for Alvis during 2004, BAe Systems obtained irrevocable commitments from a number of funds which had entered into CFDs referenced to a total of approximately 16% of the issued share capital of Alvis. Certain- of the funds entered into commitments to "request physical settlement of the CFDs in accordance with market practice …. and then to assent to the offer all shares received by them as a result of this physical settlement process" (extracted from the BAe Systems offer announcement). In the case of the other funds, the counterparty (with the express consent of the funds) gave a standard irrevocable commitment to accept the offer in respect of the shares held by it as a hedge against the funds' CFD positions;

(b) in the case of Revival Acquisitions' interest in making an offer for Marks & Spencer, a number of funds which had entered into long CFDs referenced to Marks & Spencer shares sought to put pressure on the board of Marks & Spencer to grant Revival Acquisitions due diligence access by signing letters in support of such action being taken. The funds were aware that their statements of support would be made public and clearly their intention was to influence the debate on whether due diligence access should be granted; and

(c) on a number of occasions, a person with a pre-existing CFD position referenced to a company's shares, which in certain cases has been significant, has subsequently announced an offer or possible offer for the company.

3.5 The Code Committee therefore believes that the Code and the SARs should apply to dealings in CFDs.

3.6 Although the large majority of the derivative trading activity in the UK market is, so the Code Committee understands, in the form of dealings in CFDs, the issues referred to above and which are described in further detail later in this

paper apply equally to dealings in other derivatives, such as spread bets. The Code Committee therefore believes that the Code and the SARs should apply to dealings in other derivatives as well. These issues also apply to dealings in options, notwithstanding that options have certain features which differentiate them from derivatives. For example, an option might only be exercisable at a fixed future date (as opposed to being exercisable at any point in the future); also, an option client will normally pay option money at the outset in consideration for the grant of the option. Despite these differences, the Code Committee believes that the same approach should be adopted for options as for derivatives for the following reasons:

(a) options, like derivatives, are bespoke instruments which can be structured with a view to generating the same financial return for the investor with similar gearing benefits;

(b) as with derivatives, the counterparty to an option will generally hedge its exposure by entering into transactions in the cash market or will already hold the shares which are subject to the option; and

(c) a person who holds a call option may thereby obtain de facto control over shares in a similar manner to the holder of a long CFD.

3.7 For the avoidance of doubt, the term "options" in this context (and where it is used elsewhere in this paper) applies only to options over existing shares. The proposals in this paper therefore do not apply to options to subscribe for new shares.

B. DEALINGS IN DERIVATIVES AND OPTIONS BY MARKET PARTICIPANTS (INCLUDING HEDGE FUNDS AND THE PROPRIETARY TRADING DESKS OF INVESTMENT BANKS) AND DEALINGS BY SECURITIES HOUSES AND INVESTMENTS BANKS TO HEDGE SUCH POSITIONS

4. Current position

4.1 During an offer period, the offeror, the offeree company and their respective associates are required under Rule 8.1 to disclose all dealings in relevant securities of the offeree company and, in the case of a securities exchange offer, of the offeror. This includes dealings in derivatives referenced to shares in any such company and options in respect of such shares.

4.2 Under Rule 8.3, persons who own or control 1% or more of any class of relevant securities of the offeree company or, if appropriate, the offeror (or who will so own or control 1% or more as a result of a transaction) must disclose publicly all dealings in such relevant securities of that company carried out during an offer period. However, Note 7 on Rule 8 provides that:

> "*Under Rule 8.3, a disclosure of dealings in options or derivatives is only required if the person dealing in such options or derivatives owns or controls 1% or more of the class of securities which is the subject of the option or to whose price the derivative is referenced.*"

4.3 As a result, persons whose only interests are in the form of derivatives referenced to or options in respect of shares of an offeree company (or, if appropriate an offeror), no matter how large, have no obligation to disclose their dealings under Rule 8 (as long as they are not also associates of the offeror or offeree company).

4.4 A counterparty to a large derivative or option might acquire more than 1% of a company's shares as a hedge and, as such, would prima facie have a disclosure

obligation under Rule 8.3. However, where the counterparty to the derivative or option is a recognised market-maker or principal trader under the Code, it will generally benefit from an exemption from disclosure as a result of Rule 8.3(d). As a result, many counterparties to derivative and option transactions do not disclose either the derivative or option business which they write or the transactions which they enter into to hedge those derivative or option positions, even when their shareholding is above 1%.

4.5 Accordingly, given that many hedge funds deal in UK equities only in the form of CFDs or other derivative or option instruments, and given that the counterparties to those dealings are often the market-making or prime brokerage desks of investment banks which qualify for the Rule 8.3(d) exemption, a significant proportion of market activity in respect of the shares of an offeree company (or, if appropriate, an offeror) is not disclosed, even where large derivative or option positions are involved.

4.6 Under SAR 3, which applies whether or not a company is in an offer period, a person must disclose any acquisition of shares or rights over shares which takes his aggregate holding of shares and rights over shares to between 15% and 30%. Persons who deal in derivatives are not normally required to disclose their dealings under SAR 3 as, although an option constitutes a legal right over shares, a derivative does not. Also, the counterparties to derivative and option transactions only have to disclose their dealings once their holding of shares and rights over shares reaches 15%, and even then there is no requirement to disclose details of any associated derivative transactions.

5. Rationale for requiring the disclosure of dealings in derivatives and options

5.1 Before explaining its proposed framework for amending the rules in the Code and the SARs relating to the disclosure of dealings in derivatives and options, the Code Committee considers that it is important to make clear its rationale for proposing increased disclosure of dealings in such instruments during an offer period. The Code Committee believes that there are three reasons which support such increased disclosure:

(a) significant shareholders are required to disclose their dealings in shares and persons who have significant positions in derivatives and options should be subject to a similar obligation. This is because:

(i) as explained above, the Code Committee understands that persons with long derivative positions may exercise a significant degree of de facto control over the shares to which the derivative is referenced or which are subject to the option. The Code is concerned with the passing or potential passing of control of a company, and the success or failure of a bid depends on the level of acceptances or, in the case of a scheme of arrangement, the level of votes cast in favour. It is therefore important for shareholders and for the market generally to know when persons with significant interests in derivatives and options deal in such instruments in order to understand where effective control of a company's shares in practice lies. Providing transparency as to the location of control of a company's shares was one of the main reasons for the introduction of Rule 8.3. In addition, in respect of many types of option (and, in practice, derivatives), an investor can acquire, at a moment of his choosing, the number of shares which are the subject of the instrument, no matter how illiquid the company's shares may be; and

(ii) as evidenced by the recent cases of Alvis and Marks & Spencer, persons with long derivative positions are increasingly behaving as if they were shareholders;

(b) an additional rationale for introducing Rule 8.3 was to assist in establishing whether persons with significant interests in shares may be dealing with a view to assisting the offeror or the offeree company such that they should be considered to be acting in concert with that party. On the basis that persons dealing in derivatives and options may equally be dealing with a view to assisting one of the parties to the offer, and in view of paragraph (a) above, this rationale therefore applies in the same way to persons with large positions in derivatives and options; and

(c) since the counterparty to a derivative is likely to hedge its position by dealing in the cash market (which may have an impact on the prevailing market price), the disclosure of dealings in such instruments would enable shareholders to understand better the forces at work in the market and, in particular, the reasons why an offeror or offeree company's share price may be moving in a particular direction. Similar considerations apply in respect of dealings in options.

5.2 At the most basic level, there is an argument that, since a significant element of market activity has moved from the cash market to the derivative market, the disclosure regime should move accordingly.

Q1. Do you agree in principle that the Code and the SARs should apply to dealings in derivatives and options?

6. What derivative and option instruments should be subject to the new dealing disclosure regime?

6.1 The Code Committee understands that most dealings in single stock derivatives in the UK are in the form of CFDs. There is therefore an argument that any new disclosure rules should focus solely on dealings in CFDs. Since a CFD is a relatively well understood and simple instrument, the new rules could be formulated without too much difficulty and would be relatively simple to apply. However, such a regime would be extremely easy to circumvent. For example, a person could achieve the same economic effect to a CFD by entering into put and call options, perhaps with separate counterparties, each of which was exercisable at the same price. Since the avoidance of disclosure is currently a clear benefit associated with dealings in CFDs, market participants would rapidly develop instruments which fell outside the definition of a CFD, and were therefore not disclosable, but which had similar characteristics.

6.2 In the light of this, the Code Committee considered whether disclosure might be required of dealings in CFDs and all instruments which have a similar

economic effect to a CFD. However, the Code Committee rejected this possibility on the basis that rules for the disclosure of dealings need to be clearly framed so that practitioners, compliance officers and market participants can readily understand whether a dealing in a particular instrument does or does not need to be disclosed.

6.3 A simple way of achieving clarity in this area would be to require the disclosure of dealings in all derivatives referenced to and options in respect of shares in the offeree company (or, if appropriate, the offeror), regardless of whether they are physically or cash settled. The disadvantage with casting the net widely in this manner would be that it would require the disclosure of dealings in certain instruments which might not be considered to be the prime target of the disclosure rules. To a degree, this could be addressed by providing exemptions from disclosure in appropriate circumstances.

6.4 The Code Committee has considered carefully whether there is a way of framing the regime sufficiently broadly to avoid it being capable of being easily circumvented whilst at the same time being not so broad as to capture dealings in all derivative and option instruments. The Code Committee does not believe that this is possible and therefore believes, on balance, that a wide regime is preferable. However, there would be exemptions from disclosure for dealings in derivative and option instruments which have no bearing on an offer, including the existing exemption for dealings in derivatives referenced to or options in respect of baskets or indices which include a non-material element of Code relevant securities.

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Q2. Do you agree that the new regime should require the disclosure of dealings in all derivatives referenced to, and options in respect of, shares in an offeree company and, where appropriate, the offeror?

7. In what circumstances should a disclosure obligation be triggered?

7.1 There are many possibilities in answering this question. The principal issues are as follows:

(a) at what percentage level should a disclosure obligation arise?

(b) should a disclosure obligation arise only where a person has a long position in excess of this level or also if a person only has a short position in excess of it?

(c) what types of position should be taken into account in establishing whether a person has a position in excess of the stipulated level and should those positions be aggregated? If so, should the positions be considered on a gross or a net basis?

(d) what events should trigger a disclosure obligation?

The Code Committee's views on each of these issues is set out below.

At what percentage level should a disclosure obligation arise?

7.2 The Code Committee believes that, consistent with Rule 8.3, a disclosure obligation should arise where a person has a long position (on the basis set out below) of 1% or more in any class of shares (or security carrying rights to convert into or rights to subscribe for shares) of the offeree company or, in the case of a securities exchange offer, of the offeror or where a person comes to have such an interest as a result of a dealing.

Q3. Do you agree that the disclosure obligation should arise at the 1% level?

Should a disclosure obligation arise only where a person has a long position of 1% or more or also if a person only has a short position of 1% or more?

7.3 The Code Committee considers that the first two reasons stated in paragraph 5.1 above for extending the disclosure regime carry the most weight. The first of these (disclosing the location of control) applies only in respect of long

positions and the second (disclosing potential concert party dealings) is most likely to be relevant when persons take long positions in the relevant company's shares. Accordingly, the Code Committee is of the opinion that the disclosure obligation should be triggered only where a person holds or acquires a long position in respect of shares of 1% or more. This is consistent with the existing application of Rule 8.3. Although the Code Committee recognises that there are potential concerns about the use of short selling for manipulative purposes, the Code Committee believes that the most important concern is to address the use of derivatives and options to influence or control shares.

7.4 However, consistent with the amendments proposed to Note 5(a) on Rule 8 in PCP 2004/3, a person who incurs a disclosure obligation on account of a long position of 1% or more in one class of shares should also be required to disclose any short position which he may also have in respect of shares of that company – see paragraph 7.2 of PCP 2004/3. This is in order to ensure that the person disclosing reveals his entire interest in respect of relevant securities of the company in question. For the avoidance of doubt, taking (or increasing) a short position would only trigger a disclosure obligation where the person also has a long position of 1% or more.

Q4. Do you agree that a disclosure obligation should arise only where a person has a long position of 1% or more and not if a person only has a short position of 1% or more?

What types of position should be taken into account in establishing whether a person has a long position of 1% or more and should they be aggregated? If so, should they be considered on a gross or a net basis?

7.5 The Code Committee believes that, in establishing whether a person has a long position of 1% or more, the following interests should be aggregated: physical long positions, call options, long derivative interests and written put options. These interests should be aggregated by class of relevant security (i.e. holdings of ordinary shares should be aggregated with long CFDs referenced to ordinary shares, but not with holdings of convertible bonds).

7.6 Thus, a person holding 0.5% of the ordinary shares and 0.3% of the convertible bonds of an offeree company and who enters into a long CFD referenced to 0.4% of the ordinary shares would not have to disclose the dealing (as he would hold a long position in respect of only 0.9% of one class of security and of 0.3% of another). If he then entered into a call option over a further 0.5% of the ordinary shares, this would be disclosable as he would then have a long position in respect of 1.4% of the ordinary share class. At that time, the holding of convertible bonds would also need to be disclosed (see paragraphs 6.9 to 6.11 of PCP 2004/3).

7.7 The Code Committee also believes that in establishing whether a person has a long position of 1% or more, all long positions should be taken into account regardless of whether they are in or out of the money. So, for example, a person with a long CFD referenced to 0.6% of a company's shares and a call option over a further 0.5% should be required to disclose his dealings even if the call option was out of the money. The Code Committee believes that if it were only to require the disclosure of dealings in instruments which were, at the time of the dealing, at or in the money, the regime could easily be circumvented by persons dealing in instruments which were marginally out of the money. In addition, whilst an alternative approach could be to require disclosure in the event that the instrument were to become in the money, the Code Committee believes that a disclosure obligation should be triggered on account of a person's actions as opposed to market movements.

Q5. Do you agree that all physical long positions, call options, long derivative positions and written put options should be aggregated in establishing whether a person has a long position of 1% or more?

7.8 The Code Committee considers that, as is currently the case, in establishing whether a disclosure obligation is triggered, what is relevant is a person's gross interest. Accordingly, a person who has, for example, a 3% long position and a 3.5% short position in respect of the same class of shares should be subject to a disclosure obligation. The reason for this is that the person concerned controls

3% of the class of share in which he has a long position, albeit that his net economic position in respect of such shares is 0.5% short. Furthermore, if a person's net position were to be the yardstick for determining whether he had a disclosure obligation, a person with a long position of over 1% could easily avoid disclosure simply by also taking out a significantly out of the money short position.

Q6. Do you agree that the 1% disclosure level should be triggered by reference to a person's gross long position?

What events should trigger a disclosure obligation?

7.9 The Code Committee believes that events which should trigger a disclosure obligation when a person deals in derivatives or options should be set out in the Code and should broadly correspond with Note 2 on Rule 8 as it is proposed to be amended by PCP 2004/3, namely:

(a) in respect of derivatives, the acquisition of, disposal of, entering into of, closing out of, exercise (by either party) of any rights under or variation of the terms of the derivative; and

(b) in respect of options, the taking, granting, acquisition, disposal, exercising or variation of the terms of the option.

Q7. Do you agree that events which should trigger a disclosure obligation should be set out in the Code and should be those set out above?

8. What information should be disclosed in respect of the dealing?

8.1 The Code Committee is of the view that when the disclosure of dealings in derivatives and options is required, the rules should require that all information material to the transaction should be disclosed. In the case of a derivative, this should include as a minimum the number of securities to which the derivative is referenced, the closing out date (if any) and the reference price, together with a

description of the derivative instrument itself; in the case of an option, this should include as a minimum the number of shares under option, the exercise date(s), the exercise price, any option money paid and a description of the option instrument. Assuming, as proposed in paragraph 11.1 below, that the disclosure obligation should lie with the holder of the derivative or option, the Code Committee does not believe that it would be necessary for the identity of the counterparty also to be disclosed. The Code Committee envisages that the disclosures would be made on standardised forms along the lines of those attached as Appendix B to PCP 2004/3.

8.2 The Code Committee also believes that, consistent with the Panel's existing policy, disclosures should be made on a group-wide basis. However, in line with its existing practice under Rule 8.3 and SAR 3, the Panel may be prepared to grant dispensations under which individual entities may not be required to aggregate their holdings and dealings with other members of their group, subject to the Panel being satisfied that the entity in question is operated and managed independently from the remainder of the group.

8.3 The Code Committee recognises the sensitivities associated with requiring all material information, particularly the price of the transaction, to be disclosed but believes that this approach is justified for the following reasons:

(a) only if all relevant details are disclosed is the market properly able to understand the dealing in question and to make an informed assessment of the extent to which the person dealing may be able to influence or control shares in the company. To take a simple example, the disclosure of a call option is of little benefit without knowing at least the option money paid, the exercise price and the exercise period – otherwise it is unclear whether the option is in or out of the money; and

(b) it is what is already required under Rule 8 in respect of both dealings in shares and dealings in derivatives and options by offerors, offeree companies and their associates and by 1% shareholders.

8.4 The Code Committee recognises that a wide disclosure obligation of this nature could easily lead to complicated disclosures being made. However, as explained above, the reason why Rule 8 currently requires all relevant details of a transaction to be disclosed is to ensure that shareholders are properly informed and able to make their own assessment of the transaction. The Code Committee is of the view that this philosophy should not be set aside just because a disclosure may be complicated.

8.5 One final, but important, point is that the Panel will continue to be able to give guidance on the interpretation and application of the rules. Accordingly, if a person is in any doubt as to whether a disclosure obligation has been triggered or as to how the disclosure should be made, he will be able to establish this from the Panel.

Q8. Do you agree that the rules should require that all information material to the transaction should be disclosed as set out above?

9. At what point in time should a person's interest be evaluated and by what time should the disclosure be made?

9.1 The Code Committee recognises that persons who deal in derivatives and options often trade in and out of positions frequently. This is particularly so in respect of derivatives and options referenced to or in respect of the shares of companies subject to a takeover where rapid developments may take place during a short period of time. As a result, a person's interest could increase and decrease through the 1% level during the course of a day. Accordingly, the Code Committee considers that it may be beneficial for there to be a single point in time by reference to which a person should be required to evaluate whether his interest is above or below 1% and the Code Committee believes that this time should be midnight (London time) each day.

9.2 With regard to the time by which the disclosure must be made, Rule 8.3 currently requires dealings (including dealings in derivatives and options which are required to be disclosed under Note 7 on Rule 8) by 1% shareholders to be

disclosed by 12 noon (London time) on the business day following the date of the dealing. Dealings (again, including dealings in derivatives and options) by offerors, offeree companies and their respective associates must also be disclosed by the same time.

9.3 The Code Committee believes that if the disclosure regime is amended as proposed, the deadline for publishing disclosures should remain at 12 noon (London time) on the business day following the date of the dealing. This is because during a takeover, which will often be a dynamic and fast-moving transaction, it is important that material information is disclosed to the market in as timely a manner as possible.

Q9. Do you agree that a person should be required to evaluate his position at a fixed point in time and that this should be midnight (London time) each day?

Q10. Do you agree that the disclosure of dealings in derivatives and options should be required to be made by 12 noon (London time) on the business day following the date of the dealing?

10. Should there be a de minimis exemption from disclosure?

10.1 Given the frequency with which a number of investors deal, and given that the market is only likely to be interested in material changes in a person's interest in relevant securities, the Code Committee has considered whether it would be beneficial to introduce a de minimis exemption into Rule 8.3 (in addition to the fact that the disclosure obligation is only triggered at the 1% level in the first place). This could, for example, take the form of an exemption from having to disclose where any person's gross interest following a dealing is within 0.5% (long or short) of his previously disclosed interest (i.e. such that no disclosure obligation would arise if a person's interest increased from 3.2% to 3.6% provided that the 3.2% position had previously been disclosed). Alternatively, the rules could stipulate that the disclosure obligation would only be incurred if a person's total long or short position increased or decreased to or beyond a

whole percentage figure (i.e. such that a disclosure obligation would arise if a person's interest increased from 3.9% to 4.1% but not if it increased from 4.1% to 4.9%).

10.2 Whilst the Code Committee believes that there are obvious advantages in introducing a de minimis exemption, it recognises that it may be of limited benefit in practice to those organisations which are already subject to the requirements of Rule 8.3 and which have systems in place to comply with the Rule in its current form. However, such an exemption may be of more interest to organisations such as hedge funds which characteristically only deal in CFDs and other derivatives.

10.3 The Code Committee recognises that if a de minimis exemption were to be adopted, the following points would be relevant:

(a) as stated above, the exemption should apply in respect of all dealings subject to Rule 8.3, including dealings in the cash market;

(b) the requirement for there to be a fixed point in time by reference to which a person's interest would need to be analysed would become all the more important. As stated above, the Code Committee believes that this should be midnight (London time) each day;

(c) whenever a disclosure obligation was triggered, there would arguably need to be a requirement to disclose not only any dealings which took a person's interest to or beyond the disclosure threshold but also the details of any undisclosed dealings which had taken place within the parameters of the de minimis exemption. Otherwise, in respect of the second proposal referred to in paragraph 10.1 above, a person could, for example, purchase shares which had the effect of increasing his long position from 1.2% to 1.9% and subsequently enter into a derivative which increased his long position to 2.3% and only have to disclose the latter transaction. However, the shares may have been purchased at a much higher price than the reference price of the derivative and it would be important for this to be disclosed to the market as it may be relevant in

determining whether the person dealing was acting in concert with the offeror (i.e. the reason listed in paragraph 5.1(b) above); and

(d) the regime would have to take account of the proposal that long and short positions should not be netted off (see paragraph 7.8 above). Therefore there would need to be separate aggregating for de minimis purposes of both long and short positions of shares, options and derivatives. This would lead to significant complexities in the regime.

10.4 On balance, the Code Committee has concluded that the attractions of a de minimis regime are outweighed by its complexity and the likely costs to market participants of implementing the systems to apply it.

Q11. Do you agree that the benefits of a de minimis exemption from disclosure are outweighed by its likely complexity and the costs of its implementation?

11. Who should be required to disclose any dealings in derivatives and options?

11.1 The Code Committee believes that the person responsible for disclosing the dealing should be the investor (i.e. the derivative or option holder). Accordingly, in the context of, for example, a simple long CFD, the disclosure should be made by the CFD holder and not by the investment bank or securities house counterparty. The Code Committee believes that this is appropriate because:

(a) it is generally the investor which will be the driving force behind the transaction;

(b) it is the influence which the investor has in practice over any hedge shares which is the primary justification for extending the disclosure regime as proposed. Accordingly, it is logical that the investor should be subject to the disclosure obligation;

(c) only the investor knows his full position in respect of a company's shares. A long CFD holder may, for example, have a number of positions in respect of a single class of share with a number of different counterparties; and

(d) it is consistent with what is currently required under Rule 8.

11.2 In the light of the above, the Code Committee believes that the exemption from disclosure for market-makers and principal traders under Rule 8.3(d) should continue to apply. As a result, save as set out below, organisations which qualify for this exemption should continue to be able to provide liquidity and to write derivative and option business and hedge any positions thereby incurred without being required to disclose either the derivative transaction or the hedging transaction publicly under Rule 8.3. However, if the market-maker or principal trader is connected to the offeror or offeree company, then it will be presumed to be acting in concert with that party unless it benefits from exempt status. Accordingly, in each case, the usual consequences under the Code will apply – that is to say, if the principal trader benefits from exempt status, the restrictions and requirements of Rule 38 will apply and, if it does not, any dealings by it will be treated as dealings by a person acting in concert with the party with which it is connected. For the avoidance of doubt, the Rule 8.3(d) exemption will not be available to any person who is fulfilling an intermediary function (such as writing option or derivative business) but will continue to apply only to organisations which qualify as principal traders under the Code.

11.3 An important proviso to the continued application of the Rule 8.3(d) exemption as referred to above is that the Code Committee believes that it should not be available to the proprietary trading desk (or the equivalent trading operation) of an investment bank – i.e. the desk, if there is one, within an investment bank which invests (and puts at risk) the bank's own capital. This is because the Code Committee sees no reason why such an entity should be treated any differently from any other investor. The Code Committee anticipates that individual investment banks will have to consult with the Panel to establish which entities within their organisation will be required to disclose their

dealings under Rule 8.3 and which entities can continue to benefit from the exemption contained in Rule 8.3(d).

11.4 An alternative to the approach referred to in paragraph 11.1 above would be also to require the counterparties to all derivative and option transactions (including market-makers and principal traders) to disclose publicly details of all such business which they write, in each case providing details of the investor client. However, the Code Committee is reluctant to recommend this option as it believes that this may cause confusion in the market as it would inevitably be difficult to reconcile which disclosures were linked through being related to the different components of a single transaction.

Q12. Do you agree that the obligation to disclose dealings in derivatives and options should lie with the investor (i.e. the derivative or option holder)?

Q13. Do you agree that the proprietary trading desk of an investment bank should not benefit from the exemption from disclosure in Rule 8.3(d)?

12. SAR 3

12.1 If Rule 8 is amended as set out above to require the disclosure of dealings in derivatives and options, the Code Committee proposes that corresponding amendments should also be made to SAR 3. As a result, any person who acquires a long position (as determined above) which has the effect of increasing his aggregate long position in respect of shares carrying voting rights through 15%, or, if it were previously between 15% and 30%, to or beyond a whole percentage point, would be required to disclose the dealing in question. Likewise, where persons are required under SAR 5 to aggregate their holdings and they have a long position of between 15% and 30% in respect of shares carrying voting rights which they reduce below any whole percentage point, they would have to notify the company in question under Note 3 on SAR 5. For the avoidance of doubt, the Code Committee does not propose that full

details of all dealings between whole percentage points (i.e. along the lines set out in paragraph 10.3(c) above) would need to be disclosed under SAR 3.

12.2 There is no exemption to SAR 3 for market-makers and principal traders. As a result, one consequence of amending SAR 3 in this way would be that, if, within the parameters of SAR 1, a person takes out long CFD positions with the same counterparty referenced to an aggregate of more than 15% of a company's voting rights which are fully hedged, disclosures would be made by both the holder of the CFD and the counterparty.

Q14. Do you agree that SAR 3 and Note 3 on SAR 5 should be amended to require the disclosure of dealings in derivatives?

C. DEALINGS IN DERIVATIVES AND OPTIONS BY PARTIES TO AN OFFER AND PERSONS ACTING IN CONCERT WITH THEM AND BY PERSONS WHOSE INTERESTS, TOGETHER WITH THE INTERESTS OF PERSONS ACTING IN CONCERT WITH THEM, FALL INTO THE 30% TO 50% BAND

13. Current position

13.1 As explained above, during an offer period, the offeror, the offeree company and their respective associates are required under Rule 8.1 to disclose any dealings in relevant securities of the offeree company and, in the case of a securities exchange offer, of the offeror. This includes dealings in derivatives referenced to shares in any such company and options in respect of any such shares. However, the question arises as to what other implications should arise under the Code and the SARs where parties to an offer or persons acting in concert with them, or persons whose interests (together with the interests of persons acting in concert with them) fall into the 30% to 50% band, deal in such instruments.

13.2 The rules of the Code and the SARs referred to below are particularly relevant in this regard. In each case, the existing application of the rule to derivative and

option transactions is described on the assumption that there is no side agreement in place under which, for example, the counterparty agrees to vote the hedge shares according to the wishes of the derivative holder. Where such an agreement exists, the Panel will normally apply the relevant rule in the same way as if the underlying shares had been acquired.

(a) Rule 5/SAR 1: Rule 5 and SAR 1 operate at different levels of holding and constrain the speed at which a person can accumulate shares or rights over shares in a company. Under Rule 5, broadly speaking, a person is, with certain exceptions, prevented from acquiring shares or rights over shares where to do so would take his and his concert parties' aggregate holding of shares carrying voting rights and rights over such shares to 30% or more or, where the aggregate holding is already between 30% and 50%, would increase that holding. The main exceptions are acquisitions from a single shareholder and acquisitions which are immediately followed by the announcement of a recommended offer. SAR 1 operates similarly to restrict a person's acquisitions of shares carrying voting rights and rights over such shares to less than 10% within any seven day period if that would take his aggregate holding of such shares and rights over such shares to between 15% and 30%.

At present, a cash-settled long derivative position is not relevant for the purposes of Rule 5 or the SARs, but a call option is because it amounts to a legal right over shares. As a result, a person can effectively circumvent SAR 1 and Rule 5.1 by dealing in CFDs referenced to shares in a company. For example, a person could enter into CFDs referenced to 29.9% of a company's shares, acquire a further 14.9% in the form of shares and then announce a unilateral offer (without breaching either SAR 1 or Rule 5.1) in the knowledge that just under 45% was effectively "onside".

(b) Rule 9: under Rule 9.1, where a person acquires shares which take the aggregate of his holding of voting rights and that of persons acting in concert with him to 30% or more or, if he and his concert parties already hold between 30% and 50%, where he acquires any further voting rights, he must make a mandatory cash offer to all shareholders in the company at no less than the

highest price paid by him or any person acting in concert with him for shares carrying voting rights during the offer period and the 12 months prior to its commencement (see Rule 9.5). There is no requirement under the Code for such a mandatory offer to be made to persons acting in concert with the offeror and, under Rule 9.3, such an offer must be conditional only upon the offeror and any person acting in concert with him together holding shares carrying in aggregate more than 50% of the company's voting rights.

At present, a long derivative position in a company's shares would not necessarily be taken into account in determining whether Rule 9.1 had been triggered. However, the Panel would be concerned as to whether the holder of the derivative and the counterparty were acting in concert in respect of the hedge shares. Furthermore, the parties would need to satisfy the Panel that the holder of the derivative did not have effective control over such shares. In either case, the acquisition of any hedge shares by the counterparty could have the effect of triggering Rule 9 if, when aggregated with any shares held by the CFD holder and its concert parties, they exceeded 30% of the company's voting rights.

Under Note 11 on Rule 9.1, the position with regard to options is as follows:

> "*In general, the acquisition of … options does not give rise to an obligation under this Rule to make a general offer but the exercise of … options will be considered to be an acquisition of shares for the purpose of the Rule.*
>
> *The taking of an option will, however, normally be regarded as constituting the acquisition of shares giving rise to such an obligation where the relationship and arrangements between the two parties concerned are such that effective control over those shares has passed to the taker of the option.*"

The Code Committee understands that, to date, the Panel has interpreted the second paragraph of Note 11 relatively narrowly and has concluded, for

example, that a mandatory bid obligation will normally only be triggered where the terms of the option agreement are such that it is highly likely, if not inevitable, that the option will be exercised (because it will be in one party's interests to do so) – for example, where A (a 5% shareholder in C) and B (a 28% shareholder in C) enter into a put and call option over A's stake where the put and call are exercisable at the same fixed price.

(c) Rules 6 and 11: under Rule 6, where an offeror or any person acting in concert with it acquires shares in the offeree company during the offer period or in the three months prior to its commencement, the offer must normally be made on no less favourable terms. Similarly, under Rule 11, the acquisition of shares by an offeror or a person acting in concert with it may in certain circumstances lead to an obligation that the offer (or an alternative to the offer) is made in the same specie (i.e. cash or shares) as the consideration for which the shares were acquired.

At present, an offeror which enters into a derivative referenced to shares in the offeree company will not normally trigger an obligation under Rule 6 or Rule 11 unless he closes out the derivative and acquires the underlying hedge shares. Similarly, an offeror which enters into an option in respect of shares in the offeree company will not normally trigger Rule 6 or Rule 11 unless he exercises the option, in which case he will be treated as having purchased the shares at a price calculated by reference to the price paid for the option and the exercise terms (see Note 6 on Rule 6 and Note 10 on Rule 11.1).

(d) Rule 16: under Rule 16, an offeror and persons acting in concert with it "may not make any arrangements with shareholders and may not deal or enter into arrangements to deal in shares of the offeree company, or enter into arrangements which involve acceptance of an offer, either during an offer or when one is reasonably in contemplation, if there are favourable conditions attached which are not being extended to all shareholders". The Code Committee understands that the Panel applies Rule 16 to persons who are holders of derivatives and options in the same way as if they were shareholders. Accordingly, the Code Committee understands that the Panel would consider it

contrary to Rule 16, and therefore in breach of the Code, for an offeror to enter into a special deal with a person who had a long derivative position referenced to shares in the offeree company.

(e) Rule 20.1: under Rule 20.1, information about companies involved in an offer must be made equally available to all shareholders as nearly as possible at the same time and in the same manner. Under Note 3 on Rule 20.1, the offeror and offeree company or their respective advisers may only hold meetings during an offer period with shareholders of either the offeror or offeree company, analysts, stockbrokers or others engaged in investment management or advice on the condition that such meetings are attended by a representative of the financial adviser or corporate broker to the offeror or offeree company. The representative must confirm in writing to the Panel that no material information and no significant new opinions were expressed at the meeting. The Code Committee understands that the Panel would expect a meeting with a person who had a long derivative position referenced to, or an option in respect of, shares in the offeree company or the offeror to be policed in this way. If material new information or opinions were disclosed, these would need to be publicly announced.

14. Possible ways of amending the Code and the SARs

14.1 The Code Committee has been considering to what extent these (and other) provisions of the Code and of the SARs should be amended to apply to dealings in derivatives and options. The Code Committee believes that there are two possible ways forward, namely a narrow approach and a broad approach, and these are described below.

The narrow approach

14.2 Under the narrow approach, the key focus is on preventing the use of long CFDs and other derivatives as a means of accumulating a long position in shares in excess of the relevant thresholds prescribed under Rule 5.1 and SAR 1. There would still be the possibility that an investor could avoid the

restrictions by entering into a long derivative with, or purchasing shares from, a single shareholder to take his aggregate holding of shares, rights over shares and long derivatives to 30% or more. In that event, a mandatory offer would be required if the Panel were satisfied that the underlying investor had effective control over shares which were the subject of the relevant long derivative(s) or option(s).

14.3 In detail, the narrow approach is as follows:

(a) Rule 5/SAR 1: amend Rule 5.1 and SAR 1 to apply also to dealings in long derivatives referenced to shares carrying voting rights in a company, regardless of whether, or how, the counterparty hedges its position. This could most easily be achieved by regarding a derivative referenced to such shares as equivalent to a "right over shares". This would mean that a person (and his concert parties) could only acquire shares or a call option or enter into a long derivative which took his aggregate long position through a Rule 5 threshold in the circumstances permitted by Rule 5.2.

In addition, under SAR 1, in any rolling seven day period, a person (and persons with whom he is acting by agreement or understanding) could only acquire a long position (i.e. shares, call options and long derivatives) in respect of 10% or more of a company's voting rights if that would take his aggregate long position to between 15% and 30% in the circumstances permitted by SAR 2.

In respect of both Rule 5 and SAR 1, a person's (and his concert parties') aggregate long position would be calculated on a gross basis and would not be netted off against any short positions held. Furthermore, if a person entered into a derivative or acquired an option in circumstances permitted by SAR 2 or Rule 5.2, the acquisition of the shares to which the derivative was referenced, or the exercise of the option, would not also be subject to the restrictions in SAR 1 or Rule 5.1, as appropriate;

(b) Rule 9: make no amendment to Rule 9.1 itself, but amend the second paragraph of Note 11 on Rule 9.1 to apply also to dealings in long derivatives referenced to shares. In addition, Note 11 on Rule 9.1 would include a list of factors by reference to which the Panel should determine whether effective control over the shares to which the derivative is referenced, or which are subject to the option, has passed. These would include (i) the rationale for the transaction, (ii) whether any agreements or understandings exist relating to how the voting rights attaching to the underlying shares should be exercised or what should happen to the underlying shares upon the derivative being closed out, and (iii) any previous pattern of behaviour in respect of similar transactions between the two parties. In practice, this would widen the circumstances in which a bid obligation might be incurred under Note 11.

There would also be a requirement for a person to consult the Panel before he acquired shares or a call option or entered into a long derivative which would result in his aggregate long interest in shares (including in options and derivatives) crossing a Rule 9 threshold (even though this could only take place in the circumstances permitted by Rule 5, as amended above). This would enable the Panel to determine in advance whether the transaction would have the effect of triggering a mandatory bid obligation.

If the Panel concluded that effective control over the shares to which the derivative was referenced or which were subject to the option had passed to the person concerned, then the other elements of Rule 9 would be applied on the basis that that person, and not the counterparty, had acquired any hedge shares. Accordingly, the hedge shares would count towards satisfaction of the Rule 9.3 acceptance condition and the price paid by the counterparty to acquire such shares would be relevant in determining the minimum price of the mandatory offer for the purpose of Rule 9.5.

If the counterparty did not in fact hedge its position by purchasing shares (because, for example, it had also written an offsetting short derivative), the offer price would be determined by reference to the derivative reference price or the option exercise price plus option premium paid, as appropriate. The

shares to which the derivative was referenced (or which were subject to the option) would nonetheless still count towards satisfaction of the Rule 9.3 acceptance condition;

(c) Rules 6 and 11: amend Rules 6 and 11 to provide that where an offeror or a person acting in concert with it enters into a derivative referenced to, or an option in respect of, shares in the offeree company during the relevant period and where effective control over the shares to which the derivative is referenced, or which are subject to the option, has passed, Rules 6 and 11 would be triggered at the time that such effective control passed and by reference to the price paid to acquire such effective control. In establishing whether effective control over such shares has passed, the Panel would apply the same factors as those set out in paragraph 14.3(b) above in the context of Note 11 on Rule 9.1. In all other circumstances, these provisions would not be triggered unless the offeror closed out the derivative and acquired the hedge shares. In such circumstances, the Rule would be triggered at the time that, and by reference to the price at which, the shares were acquired by the counterparty. In respect of options, the position would remain as set out in Note 6 on Rule 6 and Note 10 on Rule 11.1, namely that the price would be the exercise price plus the option money paid;

(d) Rule 16: amend Rule 16 to make clear that persons with long derivative and option positions referenced to or in respect of shares are subject to the Rule in the same way as shareholders; and

(e) Rule 20.1: amend Rule 20.1 to make clear that it applies to information given to persons with long derivative and option positions referenced to or in respect of shares as well as to information given to shareholders.

14.4 The arguments in favour of the narrow approach are as follows:

(a) by amending SAR 1 and Rule 5.1 as set out above to apply to dealings in long derivatives, these provisions would no longer be capable of being circumvented in the manner set out in paragraph 13.2(a) above;

(b) by amending Note 11 on Rule 9.1 as set out above, the Panel would have the ability to require a mandatory bid to be made in circumstances where it believed that effective control over the hedge shares had passed to the holder of the long derivative or the option, as appropriate. This is consistent with the Panel's historic approach in this area; and

(c) the amendments to the Code and the SARs would largely be restricted to those provisions referred to above with the result that the existing framework of the Code and the SARs would remain relatively unchanged.

14.5 The principal argument against the narrow approach is that the Panel may have difficulty in practice in proving that effective control over the hedge shares has passed to the holder of the long derivative or option, as appropriate.

The broad approach

14.6 Under the broad approach, all dealings in long derivatives and options would effectively be treated as dealings in the underlying shares for the purposes of the Code and the SARs. This would be justified on the basis that, as explained in paragraph 3.2 above, (i) it is market practice for the counterparty writing the long derivative or option transaction to hedge its exposure by dealing in the cash market, and (ii) the holder of a long derivative or option will in practice exercise a significant degree of de facto control over the number of underlying shares to which the derivative is referenced or which are the subject of the option.

14.7 In more detail, the broad approach is as follows:

(a) Rule 5/SAR 1: amend Rule 5 and SAR 1 in the same way as for the narrow approach;

(b) Rule 9: amend Rule 9.1 to provide that if a person (together with his concert parties) acquired shares carrying voting rights, call options and written

put options in respect of such shares and long derivatives referenced to such shares which in aggregate amount to 30% or more of a company's voting rights, he would trigger an obligation to make a mandatory cash offer. Similarly, a person who, together with his concert parties, had an aggregate long position determined on this basis in respect of between 30% and 50% of a company's voting rights would be required to make a mandatory cash offer if he increased that long position. In each case, a bid obligation would be triggered regardless of whether the derivative or option was cash or stock settled, of whether it was in or out of the money and of whether (or how) the counterparty hedged its position.

There would also be implications for other provisions of Rule 9, the principal changes being as follows:

(i) Note 11 on Rule 9.1: amend the first paragraph to refer only to options to subscribe for new shares and delete the second paragraph (which would become redundant);

(ii) Rule 9.3: since the person concerned would be presumed to have de facto control over the shares to which the derivative was referenced or which were the subject of the option, those shares would count towards satisfaction of the Rule 9.3 acceptance condition. As with the narrow approach, this would be the case even if the counterparty did not hold such shares as a hedge;

(iii) Rule 9.5: the Code Committee believes that there are two alternative ways of addressing the issue of the price at which the offer should be made as set out below.

Option 1: amend Rule 9.5 to provide that where the offeror or a person acting in concert with it has entered into long derivatives referenced to or options in respect of shares in the offeree company during the offer period or in the 12 months prior to its commencement, it would be treated as having purchased shares at the highest derivative reference price or

option exercise price (plus any option money paid), as appropriate. This would be the case regardless of whether, or how, the counterparty has hedged its position.

The rationale for setting the price at this level would be that the mandatory bid obligation should be made at not less than the highest price that the person who has obtained or consolidated control of the company has been prepared to pay for his controlling stake (subject to the 12 month cut off). The argument against this approach is that it might be considered harsh where a person has entered into an out of the money derivative or option since he would not have acquired any shares at that price nor would the counterparty be likely to have acquired any shares at that level (assuming that the instrument has not subsequently become in the money) – however, that person will know in advance the consequences of crossing the Rule 9 threshold.

Option 2: amend Rule 9.5 to provide that where the offeror or a person acting in concert with it has entered into long derivatives referenced to or options in respect of shares in the offeree company during the offer period or in the 12 months prior to its commencement, the mandatory offer should be made at the highest price at which the counterparty has acquired hedge shares during this period. If the counterparty did not hedge its position by acquiring the underlying shares (because, for example, it had an off-setting short derivative), the counterparty would be treated as having purchased shares at the prevailing market price at the time that the offeror (or its concert party) entered into the derivative or option.

The rationale for setting the price at this level would be that the mandatory bid obligation must be made at not less than the highest price at which a shareholder in the offeree company has been afforded an exit at the hands of the offeror or a person acting in concert with it. Where an offeror or one of its concert parties deals in derivatives or options, such an exit is effectively afforded to those shareholders from whom the

counterparty acquires any hedge shares. However, where the counterparty does not hedge its position, the bid obligation should be made at the level at which the counterparty would be likely to have hedged its position had it done so. The argument against this approach is that it may not always be easy to establish which shares were acquired by the counterparty as a hedge to a derivative or option entered into by an offeror or one of its concert parties.

Taking account of the points referred to above, the Code Committee prefers Option 1; and

(iv) Rule 9.6: amend to apply also to the writing of derivatives referenced to shares or the granting of options over shares by the directors of the offeree company;

(c) Rules 6 and 11: amend in the same way as for Rule 9.5 (although the relevant time period would be three months in the case of the amendment to Rule 6);

(d) Rule 16: amend in the same way as for the narrow approach; and

(e) Rule 20.1: amend in the same way as for the narrow approach.

14.8 The arguments in favour of the broad approach are:

(a) a mandatory bid obligation would be triggered where a person acquired an aggregate long position in shares, options and long derivatives of 30% or more and there would be no requirement for the Panel to prove that actual control over any hedge shares had passed from the counterparty to the person concerned;

(b) dealings in long derivatives and options would be treated in a consistent manner across all rules of the Code and the SARs, namely as equivalent to dealings in the underlying shares; and

(c) whilst this regime might be considered to be tough, it would only apply to offerors, potential offerors and persons with substantial interests (and, in each case, persons acting in concert with them) who chose to deal in knowledge of the consequences. If such persons were in any doubt as to the consequences of their dealings, they could consult with the Panel in advance of dealing.

14.9 The arguments against the broad approach are:

(a) the making of a mandatory offer under Rule 9 is an onerous undertaking. It might be considered harsh to impose such an obligation on a person who may not in fact have acquired control of 30% or more of a company's voting rights; and

(b) it could limit certain opportunities currently available to offerors and substantial shareholders by forcing them to deal in the cash market. For example, a potential offeror which has a 29% shareholding is currently able to acquire a call option over a stake held by a single shareholder as a potential platform for making a bid without being required to make a mandatory offer under Rule 9. Under the broad approach, this would trigger a bid obligation.

14.10 The Code Committee believes that, having regard to all these points, the broad approach is the preferable course of action.

Q15. Do you prefer the narrow approach or the broad approach and do you have any other comments on either the narrow approach or the broad approach?

Q16. With regard to the minimum price obligations contained in Rules 6, 9.5 and 11, under the broad approach do you prefer Option 1 or Option 2?

D. NEXT STEPS

15.1 The Code Committee will consider the responses to this paper and intends to publish a further Consultation Paper making firm proposals for rule changes as soon as possible thereafter.

APPENDIX: LIST OF QUESTIONS

Q1. Do you agree in principle that the Code and the SARs should apply to dealings in derivatives and options?

Q2. Do you agree that the new regime should require the disclosure of dealings in all derivatives referenced to, and options in respect of, shares in an offeree company and, where appropriate, the offeror?

Q3. Do you agree that the disclosure obligation should arise at the 1% level?

Q4. Do you agree that a disclosure obligation should arise only where a person has a long position of 1% or more and not also if a person only has a short position of 1% or more?

Q5. Do you agree that all physical long positions, call options, long derivative positions and written put options should be aggregated in establishing whether a person has a long position of 1% or more?

Q6. Do you agree that the 1% disclosure level should be triggered by reference to a person's gross long position?

Q7. Do you agree that events which should trigger a disclosure obligation should be set out in the Code and should be those set out above?

Q8. Do you agree that the rules should require that all information material to the transaction should be disclosed as set out above?

Q9. Do you agree that a person should be required to evaluate his position at a fixed point in time and that this should be midnight (London time) each day?

Q10. Do you agree that the disclosure of dealings in derivatives and options should be required to be made by 12 noon (London time) on the business day following the date of the dealing?

Q11. Do you agree that the benefits of a de minimis exemption from disclosure are outweighed by its likely complexity and the costs of its implementation?

Q12. Do you agree that the obligation to disclose dealings in derivatives and options should lie with the investor (i.e. the derivative or option holder)?

Q13. Do you agree that the proprietary trading desk of an investment bank should not benefit from the exemption in Rule 8.3(d)?

Q14. Do you agree that SAR 3 and Note 3 on SAR 5 should be amended to require the disclosure of dealings in derivatives?

Q15. Do you prefer the narrow approach or the broad approach and do you have any other comments on either the narrow approach or the broad approach?

Q16. With regard to the minimum price obligations contained in Rules 6, 9.5 and 11, under the broad approach do you prefer Option 1 or Option 2?