TAKEOVER CODE PCP 2011/1

REVIEW OF CERTAIN ASPECTS OF THE REGULATION OF TAKEOVER BIDS

RESPONSE BY NABARRO LLP

Nabarro LLP is a major corporate law firm comprising 125 partners leading approximately 400 lawyers offering a broad range of corporate legal services to major national and international clients. Our corporate group has an impressive track record of advising on both public and private mergers and acquisitions transactions where we have acted for acquirers, targets and nominated advisers. We have in the past provided secondees to serve on the executive of the Panel. We are principally involved in transactions at the top end of the mid market and during 2010 we advised clients in respect of six publicly announced takeover offers with market values ranging from £15 million to more than £150 million. In preparing our response we have drawn on our experience of advising on these and other recent takeovers and sought to apply that knowledge in a constructive and useful way to assist the Panel in its deliberations on these important issues. Nabarro is also represented on the City of London Law Society Company Law Committee which is preparing a separate response comprising views of a number of city law firms. We would be very happy to discuss all or any of the points raised in our response with the relevant Panel members if it would assist in clarifying our thoughts and developing appropriate solutions.

Q1 Do you have any comments on the proposed new Rule 2.4 and the proposed new Note 3 on Rule 2.2?

We have two principal comments in this connection, both of which are intended to reflect legitimate concerns of offeree companies:

- We still believe it is possible that the compulsory and automatic "put up or shut up" period of 4 weeks from announcement of an offer period and potential offeror may result in the withdrawal of some offers which would otherwise be welcomed by the shareholders of the offeree. Although the revised Code indicates that the Panel is "likely" to extend the period towards the end of it on application by the target, presumably there is no certainty at this stage that this will always be the case and, as such, those offerors who will not be able to launch an offer in that period of time for valid and legitimate reasons may consider the risk and costs exposure to be too great and will withdraw at that early stage. We believe that this will particularly apply to overseas bidders new to the UK market. In that scenario we wonder whether the application of the Rule by the Panel could be clarified to allow in exceptional cases for the put up or shut up period to be extended at the outset rather than at the end of the period, particularly in a situation where both offeror and offeree agree.

- Similarly the requirement to name all potential offerors in any announcement which commences an offer period seems to us likely to result in fewer persons being willing to make even preliminary investigations concerning a potential bid which involves the offeree company (other than where there is a formal sale process announced in accordance with the proposed new Note 2 on rule 2.6). We can envisage the situation whereby potential offerors who would otherwise be welcomed by the offeree would not commence any form of process if there were concerns about being named in an announcement along these lines. We wonder also whether it could be clarified that where an approach has been formally withdrawn by a potential offeror there is no requirement for any subsequent announcement to name that entity.

Q2 Do you have any comments on the proposed new Rule 2.6(a)?

See comments above in relation to Q1 as to the potential for consent in exceptional circumstances for an extension to the put up or shut up period to be granted by the Panel at the outset or prior to the commencement of the offer period.

Q3 Do you have any comments on the possible alternative approach to the identification of potential offerors?

We believe that the offeree company and its advisers are best placed to determine whether it is in the company's and its shareholders' best interests to announce the identity of the potential offeror. The assumption from the Code Committee's deliberations is that this is important information for them and other market participants in all cases. We are not convinced that this will always be the case and therefore in exceptional cases there ought to be discretion granted to the Panel not to require such disclosure if requested by the offeree company, for example because the offeree believes that the possibility of an offer being made by a particular potential offeror would be seriously prejudiced.

Q4 Do you have any comments on the proposed new Rules 2.6(b), (d) and (e) and Rule 2.3(d)?

We have no comments.

Q5 Do you have any comments on the proposed new Note 2 on Rule 2.6?

We have no comments other than as indicated above that the regime applying in respect of the formal sale process could also apply in the context of offeree companies who wish to apply for such a dispensation where there is a serious risk that without such a dispensation the likelihood is that the otherwise welcome offeror would immediately withdraw from the potential transaction. We envisage that otherwise offerees may create an artificial formal sale process and announce such a process in circumstances which would potentially prejudice the company in its other commercial arrangements.

Q6 Do you have any comments on the proposed new Rule 2.6(c) and Note 1 on Rule 2.6?

See comments at Q1 above.

Q7 Do you have any comments on the proposed amendments to Rule 2.8 and to the Note on Rules 35.1 and 35.2?

We have no comments.

Q8 Do you have any comments on the proposed framework to be applied in circumstances where, following a requirement to make an offer being triggered under Rule 2.2(c) or (d), a potential offeror ceases actively to consider making an offer, or on the proposed new Note 4 on Rule 2.2?

We have no comments.

Q9 Do you have any comments on the proposed new Rule 21.2?

We maintain the view that the existence of such deal protection measures (other than non-discussion undertakings) would not ultimately frustrate a possible competing offer. The current rule that inducement fees cannot exceed 1% of the offer value should be sufficient as it is unlikely to deter a potential offeror from making a bid (given its relatively low amount). This is particularly the case when you look at other jurisdictions where inducement fees are permitted at a higher level.

Indeed, it also overlooks the fact that inducement fees may in fact encourage offers that might otherwise not be made (or at least not be made at the original price agreed) as without them it is certainly the case that potential offerors are taking on a higher level of

transactional risk. This could act against the interests of offeree company shareholders who would usually be seeking to maximise their exit value.

In addition, by the time that an offeree board decided to accept an offer and enter into any deal protection measures, it will usually understand the price that shareholders are likely to accept and the number (if any) of other potential bidders for the target company.

We do however believe that 'non-discussion' undertakings should be prohibited on the grounds that this type of deal protection measure goes directly to the ability of other potential bidders to make an offer.

We have no comments on the drafting of the proposed new Rule 21.2.

Q10 Do you have any comments on the proposed new Note 1 on Rule 21.2?

Please see the response to Question 9 above. We agree that the position of an offeree company would be strengthened if it were permitted to enter into an inducement fee arrangement with one competing offeror where a non-recommended offer had already been announced.

We note the comments made by the Code Committee that the scope of any such inducement fee arrangement should be restricted to the same extent as the arrangements permitted under the current Rule 21.2 and as proposed under the terms of the draft Note 1.

Q11 Do you have any comments on the proposed new Note 2 on Rule 21.2?

We agree that the proposed general prohibition should not apply where an offeree board has instituted a formal auction sale process and we have no comments on the drafting of proposed Note 2.

Q12 Do you have any comments on the proposed new Note 3 on Rule 21.2?

We have no comments and agree with the Code Committee that the Panel should be able to grant a dispensation from the general prohibition in such cases.

Q13 Do you have any comments on the proposed new Note 4 on Rule 21.2?

We agree with the views of the Code Committee that any agreements or arrangements permitted under the proposed new Rule 21.2 (if implemented) should be put on display as soon as they have been agreed and entered into and certainly no later than the date of the Rule 2.5 announcement. We would reiterate the comments we made in response to consultation PCP 2010/2 that there seems to be no merit to wait until the publication of the offer or scheme document.

Q14 Do you have any comments on the proposed amendments to Appendix 7?

We note that implementation agreements which purport to compel an offeree company to convene and hold a shareholder meeting in accordance with a scheme timetable would constitute a deal protection measure and will therefore be prohibited under the new Code. In that event, we agree with the Code Committee's view that Appendix 7 of the Code be amended to require offeree companies to take such steps as are necessary to implement a scheme of arrangement to ensure that an offeror has the same certainty that it would if an offeree company had provided contractual confirmation within the terms of an implementation agreement.

In those circumstances we also agree that it would be necessary for the timetable to be agreed with the Panel in advance to enable the new Code provisions to operate effectively. Furthermore, it will be necessary to build in flexibility to accommodate any changes to the timetable that have been agreed with the offeror.

We have no comments on the form of the drafting for Appendix 7.

Q15 Do you have any comments on the proposed new Note 1 on Rule 25.2 or the related amendments?

We note and agree with the majority of the respondents to PCP 2010/2 that the Code should not be prescriptive in the factors that need to be taken into account by the board of an offeree company when considering whether to recommend an offer.

However, we are surprised by the perception of certain market participants that the offer price should be the determining factor if an offeree company is to comply with its obligations under the Code. In our view, this is not a function of the Code but rather it reflects the views of shareholders in offeree companies and, in practice, the board of directors of offeree companies will be aware of these views when deciding whether to recommend an offer.

Notwithstanding those comments, we believe it is helpful for the relevant provisions of the Code to be clarified by way of a new Note 1 to Rule 25.1 that explicitly states that offeree boards are not required by the Code to make the offer price the determining factor.

Q16 Do you have any comments on the proposed new Rules 24.16(a) and 25.8?

As set out in our responses to consultation PCP 2010/2, we agree that offer documents and the offeree board circular (as appropriate) should contain the estimated costs of the offer in aggregate, and are neutral as to whether the US approach of itemising fees by category is adopted as set out.

We are however sceptical as to whether itemisation of advisers' fees will ultimately lead to reduced fees for companies, if indeed this is the desired result. We think detailed disclosure of fees by adviser may lead towards standardisation of fee arrangements across adviser groups, as has been seen in respect of underwriting fees and commissions. This point was specifically remarked on in the OFT's recent review of underwriting fees. Greater standardisation may therefore have the effect of limiting offerors' and offerees' ability to negotiate fees that are appropriate to their particular circumstances and those of the particular transaction.

Q17 Do you have any comments on the proposed new Note 1 on Rule 24.16?

We have no comment, other than to note that in many instances details of offerors' financing arrangements will be subject to disclosure under Rule 24.2 in any event.

Q18 Do you have any comments on the proposed new Rule 24.16(b) and Note 2 on Rule 24.16?

The points made in response to Question 16 above apply equally to disclosure of the structure of fee arrangements as they do to the amount of fees. We query whether offerors and offerees will be motivated to set out narrow expectations of minimum or maximum fees where costs are variable between defined limits, as they will be reluctant to find themselves in a situation in which they may have to make an announcement as to fees materially exceeding the estimated maximum under proposed Rule 24.16(c) or (d).

We have no comment on proposed Note 2 to Rule 24.16.

Q19 Do you have any comments on the proposed new Rules 24.16(c) and (d)?

See response to Question 18 above. In addition, we note that Rule 24.16(d) would constitute post-event disclosure and would not assist shareholders in assessing the merits of an offer.

Q20 Do you have any comments on the proposed deletion of Rule 24.2(b) and Note 6 on Rule 24.2 and the related amendments?

We maintain our view that these changes are unlikely to have any significant benefit to shareholders in the offeree company. The primary focus of the Code is to protect offeree shareholders and we do not see any significant benefit to them by disclosing financial information about the offeror where the consideration is solely in cash.

In practice, there will also be such a disparity in the nature and extent of offeror financial information available in different scenarios that we query how useful the new requirements will be for shareholders. For example, an overseas company without a UK listing will almost invariably be making a cash offer only. We query how helpful it is to shareholders to have such an offeror disclosing financial information in accordance with new Rule 24.3(b), particularly if it is subject to accounting principles which are unfamiliar to UK retail investors. An even more extreme case would be the situation where the offeror is a newco set up for the purpose of making the offer, which will have little or no relevant financial information to disclose.

The purpose of the offer document or scheme circular is to enable offeree shareholders to reach a decision about whether to accept the offer or vote in favour of the scheme (as applicable). Whilst we accept that other constituencies may have an interest in financial information about the offeror, we do not agree that the offer document or scheme circular should be used to satisfy these interests.

We have no comments on the actual drafting of the proposed amendments.

Q21 Do you have any comments on the proposed new Rule 24.3(a) and the related amendments?

We have no comments.

Q22 Do you have any comments on the decision not to require *pro forma* balance sheets to be included in offer documents?

We agree with the Code Committee's decision that such a requirement would be unduly onerous.

Q23 Do you have any comments on the proposed new Rule 24.3(c) regarding the disclosure of ratings and outlooks?

We have no comments.

Q24 Do you have any comments on the proposed new Rule 24.3(f)?

We have no comments.

Q25 Do you have any comments on the proposed new Rules 26.1 and 26.2 or the related amendments?

We have no comments.

Q26 Do you have any comments on the proposed new Rule 24.2?

We have no comments.

Q27 Do you have any comments on the proposed new Note 3 on Rule 19.1?

We believe that the proposed new Note reflects the obligations of the offeror and offeree to maintain high standards of accuracy of the information contained in the offer

documentation. However, the proposed new Note 3 does not reflect the fact that circumstances can change and affect different businesses in different ways. We believe that it would be helpful if the Panel could acknowledge (whether in Note 3 or otherwise) that companies will only be held to statements as to future intent where it is reasonable to have made those statements initially. It is only in the narrative in PCP 2011/11 that reference is made to the intention of the Panel to take into account what was reasonable at the time the statement was made. In the absence of the principle of reasonableness being reflected in the Code, we would be concerned that parties to an offer will be reluctant to make substantive and meaningful statements as to future intentions as opposed to more vague and meaningless statements of intention.

Q28 Do you have any comments on the proposed new structure for the obligations in relation to the publication, content and display of documents?

It would be helpful if it could be noted that the requirements in Rules 24.1(c), 25.1(c), 32.1(b) and 32.6(a)(iii) as to providing copies of offer documentation to employees' representatives and employees are satisfied by advising of their availability on the relevant websites. Arguably, the requirement to make the documents available on a website should automatically satisfy the requirements to make the documents available, although we can see the merits in requiring separate notification to employees that they are available. The separate treatments of the requirement to make the documents available on the relevant websites and the requirement to make them available to employees suggests that the publication of the documents on the relevant websites is insufficient. The addition of a note (in the appropriate places) to the following effect would be helpful in clarifying the obligations of the parties to an offer:

"The obligation under [relevant rule] to make the [relevant document] available to employee representatives and/or employees may be satisfied by notifying the employee representatives and/or employees of the website on which such document[s] have been published."

Q29 Do you have any comments on the proposed new definition of "employee representative"?

We have no comments.

Q30 Do you have any comments on the proposed new Note 6 on Rule 20.1?

We have no comments.

Q31 Do you have any comments on the proposed new Rules 2.12(a) and (d) and second sentence of Rule 32.1(b)?

We believe that it would be helpful to provide the same clarification in respect of documents published on a website as described in response to Question 28 above.

Q32 Do you have any comments on the proposed new Rule 25.9 and amendments to Rule 32.6?

We have no comments on the proposed amendments to Rule 25.9 in respect of the obligation to publish the opinions of employee representatives received “out of time”.

However, we disagree with the Panel’s assessment of the likely costs involved in the employee representatives obtaining independent advice for the purpose of giving their opinion. In order to properly advise on the effects on employment of an offer, the employee representatives will require to assess the information provided to them on the future strategy etc. of the business under the offeror’s control. In order to give a meaningful opinion, the employee representatives will want to assess:

- the offeror's intentions as stated in the offer document (and, if applicable, as provided separately to the employee representatives);
- whether the employee representatives support the beliefs and assumptions of the offeror; and
- the likely effects therefore on employment for the offeree's employees.

Our principal concern lies with the second of these points – whether the employee representatives agree with the assumptions made by the offeror. In order to comment meaningfully on the effects on employment, employee representatives will need to understand the offeror's intentions as regards the offeree's business. This gives rise to the strong possibility that employee representatives will incur significant costs in engaging advisers to try and second-guess the offeror's business strategy and plans and therefore deduce the likely success (or otherwise) of the offeree business under the offeror's control in order to give their opinion to the standard required by the Code.

We would strongly question the extent to which it is appropriate for the offeree company, and therefore indirectly offeree company shareholders, to be required to bear the potentially significant additional costs to be incurred when it is highly questionable, particularly in the case of all-cash offers, what benefit there is to shareholders from having this opinion.

Indeed, as with the current position, one can ask what place these provisions properly have within the Code given that the views of employee representatives will generally be of no value or interest to shareholders considering whether or not sell their shares.

We believe that some of these concerns could be addressed by specifying that in reaching their opinion, employee representatives are entitled to rely on statements made by, and information provided by, the offeror and are not required to "test" those statements. In the absence of such a statement, we are concerned that employee representatives will be advised that in order to give their opinions, they must first test the statements of the offeror. This might lead to either increased expense for offeree companies (which do not have any option but to respond to an offer, even if it is not recommended and may fail, and incur the already significant costs in doing so) or encourage offeror companies to provide increasingly vague and meaningless information as regards their future strategy (as already referred to in our response to Question 27).

Q33 Do you have any comments on the proposed new Rule 19.2(a)(iii)?

We have no comments with regard to the proposed wording to be included in Rule 19.2(a)(iii). However, we do query whether there should be an express statement in the Code as to who is responsible, and the level of responsibility taken, for the opinion of the employee representatives?

While the amendment to Rule 19.2(a)(iii) clarifies the position as regards the offeree board, PCP 2011/1 refers to the opinion having to meet the standards required by Rule 19.1. Rule 19.1 however is heavily focussed on the parties to the offer and their respective advisers (the final sentence of Rule 19.1 tends to the suggestion that Rule 19.1 is only directed at such persons).

We believe that it is arguable that Rule 19.1 does not apply to the opinions of employee representatives and would therefore suggest that a specific statement of responsibility be applied to the opinion of the employee representatives. Such a statement of responsibility would need to reflect the position adopted in respect of the extent to which employee representatives may be entitled to seek external advice (see further our comments in response to Question 32 above). If employee representatives are to be permitted a full range of advice, then their responsibility standard should mirror that of the offeror and offeree boards. If they are to be permitted to rely on statements made by the offeror or offeree, then their responsibility standard would need to be modified accordingly.

Q34 Do you agree that the suggested amendments to section 2(a) of the Introduction to the Code would be consistent with the amendments to the Code proposed in this PCP?

Yes, save the last amendment, in the last line of the third paragraph, of "takeovers" to "takeover offers". This change does not seem to be replicated elsewhere in the Code (for example, in the first and second sentence of the first paragraph of the "Nature and purpose of the Code") and we query whether it is necessary.

Q35 Do you have any comments on the proposed new definition of "offer period"?

No comments save that in the first line "subject to" should probably read "in".

In addition, the wording that the board is seeking potential offerors has been deleted. This deletion makes sense as such an event is announceable in accordance with rule 2.2(f). However, in order to be clear what announcements trigger the commencement of an offer period, we suggest that the words "in accordance with rule 2.2" are added to the end of paragraph 3 of the proposed new definition of "offer period".

Q36 Do you have any comments on the proposed new rule 13.4?

No comments except we suggest the new rule 13.4 should apply to other conditions or pre-conditions (for example, when an offer is subject to clearance by the Pensions Regulator).

Nabarro LLP
27 May 2011