Reply from Pinsent Masons LLP to PCP 2011/1 Consultation Paper: Review of certain aspects of the regulation of takeover bids: Proposed amendments to the Takeover Code

About Pinsent Masons LLP

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We welcome the opportunity to provide feedback on the Panel's consultation. We have not sought to comment on every question in the consultation paper but have concentrated on those areas of importance to us and our clients.

A. INCREASING THE PROTECTION FOR OFFEREE COMPANIES AGAINST PROTRACTED "VIRTUAL BID" PERIODS

Generally, we feel the proposals surrounding virtual bids are very positive for offeree company shareholders. The proposals support the fundamental purpose of the Code: to create a level playing field and provide more transparency. At an early stage offeree company shareholders will know who is involved in bidding for their company and can make a decision earlier in the process. It should aid informed decision making.

However, we have some concerns that the proposed automatic 28 day period within which a potential offeror must clarify its intentions may be too short especially for private equity backed bidders.

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

Under the new Rule 2.4(a), if an offeree company receives an approach which it unequivocally rejects but none the less has to make an announcement (because there has, for example, been an untoward movement in its share price), it is proposed that the potential offeror does not need to be named. The announcement will still however start an offer period.

If a subsequent potential offeror comes along, there will be no automatic requirement (as stated in paragraph 2.7 of the consultation paper) for the offeree company to announce the existence of the new potential offeror. In this situation, no 4 week deadline will have been set for any potential offeror and the offeree company will find itself in a virtual bid situation. Surely this is not what the proposed amendments are intended to achieve?

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

The overriding concern here is that the bid process is truncated into 4 weeks and this seems particularly hard for private equity backed bidders who have many people they have to satisfy before they can undertake transactions – not only lenders of finance but investment committees. This may lead to less bids from the private equity sector.

In a recent BVCA survey[1] of investment managers and other professionals involved in buy-outs, over 90% of the respondents thought that it took at least 6 weeks to organise a bid for a public company (with 48% stating that it would take longer than 8 weeks).

[1] BVCA research note no.08

In the light of this survey, we would suggest that the deadline is extended to 6 weeks to give potential offerors more time to put their bids together and to give offeree boards more time to reflect on whether to recommend the bid.

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

We question why the 28 day deadline should not be applied to a potential offeror (or should cease to apply) where another offeror has previously been announced (or subsequently announces) a firm intention to make an offer.

Where an offeror has announced a firm intention to make an offer for an offeree company and a potential competing offeror subsequently makes a “virtual bid” announcement, offeree company shareholders are subjected to uncertainty for a prolonged period until the virtual bidder either announces a firm intention of its own accord or is forced to put up or shut up at Day 50. In this situation, provided that the "virtual bid" is regarded as credible, the offeree shareholders will not tender their shares into the first offer until the situation is clarified. We suggest that the Panel impose a deadline of the earlier of 28 days from the date the "virtual bid" is announced or Day 50 of the original offer for the position to be clarified.

Hostile offerors would otherwise continue to have a tactical advantage and may be able to frustrate the first offer by waiting until Day 50 to clarify, with the consequence that the first offeror must continue to extend its offer and, if applicable, pay commitment fees, during this period.

In the recent takeover of Regal Petroleum plc, there was very little take up of the recommended cash offer made for the company as a possible bid was subsequently announced for the company (within 20 minutes of the Rule 2.5 announcement in respect of the recommended offer). The virtual bidder "put up" on Day 50 following a statement from the Panel under Rule 19.3.

It would be helpful to include a note to the new Rule 2.6 with regard to the Panel's practice (assuming that it is not intended to change) that it would normally require a publicly named potential competing offeror to clarify its intentions by "Day 50" (or 10 days prior to the end of the 60-day offer timetable) when interpreting the term "*by a date in the later stages of the offer period*".

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

We agree with the principle that the put up or shut up regime should not apply where an offeree company has initiated a formal sale process but we are concerned as to whether the definition of "formal sale process" in the new Note 2 on Rule 2.6 will catch all circumstances where an offeree company has put itself up for sale.

We would question how often a public company undergoes a "formal sale process" as defined in the new Note 2, as in many cases it will just announce a wider strategic review.

Practice Statement No. 6 recognises that an offeree company will often announce that it is undertaking a "strategic review" of its business. The Practice Statement describes 2 possible strategic review announcements (i) a strategic review announcement that refers to an offer as a possibility and which starts an offer period and (ii) a strategic review announcement that does not refer to an offer as a possibility (and which the Panel will not treat as automatically starting an offer period). In the latter case the Practice Statement goes on to say that the Panel will normally ask the company to clarify its intentions and identify that an offer is being considered if there is rumour and speculation in the market or an untoward movement in share price (and such further announcement will start an offer period).

Does the Panel intend that the situation described in (i) above is caught by the definition of "formal sale process"? We believe that the definition should be aligned with the situation described in Practice Statement No. 6 more closely to reflect what happens in reality.

The definition could be amended to refer to "whenever an adviser has been appointed to identify potential purchasers for the offeree company or its business".

B. STRENGTHENING THE POSITION OF THE OFFEREE COMPANY

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

Inducement fees:

We can see the arguments for and against the ban on inducement fees and deal protection measures. On the one hand, an inducement fee is in some ways just a recognition of the amount of investment a potential offeror has put into making a bid and usually represents only a small proportion of what has actually been spent on due diligence etc. One could argue that it may make the UK uncompetitive compared with other jurisdictions especially the US where deal protection measures are more common. This could also hurt advisers as bidders may require advisers to do work on a contingency basis.

On the other hand, until around 15 years ago inducement fees were not a common feature of UK takeovers. The payment of inducement fees has developed apace only since the Chaston[2] case where it was decided that a fee equal to 1% or less of the company's value (based on the offer price) was unlikely to cause a material reduction in the target's net assets and so not constitute unlawful financial assistance. Before that, inducement fees were not a standard feature of UK takeovers and in our belief it is no bad thing to return to that position. It is good from the perspective of the offeree company shareholders.

Other offer-related arrangements:

New Rule 21.2 is drafted very widely and catches any agreement, arrangement or commitment proposed to be entered into between the offeree company and an offeror in connection with an offer except for the arrangements set out in the new Rule 21.2(b). The exceptions do not cover a "matching rights" arrangement whereby an offeree company grants the potential offeror the right, within an agreed timescale, to equal or better any competing bid that might be announced during the offer period and undertake to recommend that revised offer (subject to certain limited exceptions).

We would argue that a matching rights arrangement is not detrimental to offeree company shareholders but gives certainty to shareholders. We do not believe matching rights should therefore be prohibited. Obviously an offeree company board will have to consider its statutory and fiduciary duties under the Companies Act and at common law in agreeing to any such matching rights arrangement.

We understand that Rule 21.2(b) (iv) is meant to relate to irrevocable undertakings and letters of intent in relation to voting shares or accepting the offer and we believe that the drafting should be clarified by adding the words "given by persons with an interest in securities of the offeree company in that capacity only" after the word "intent".

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

As drafted it may be argued that the commitment to pay the inducement fee could survive indefinitely and we would suggest adding the words "is, or has been, announced (prior to the competing offer having lapsed or been withdrawn or (with the consent of the Panel) having not been made) and subsequently" after the words "competing offeror".

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

See comments on Question 5 above.

[2] Chaston v SWP Group plc [2003] 1 BCLC 675

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

We note the comments in paragraph 3.25 about it not being the intention to prohibit sale and purchase agreements and other documents which are required to implement a "whitewash" transaction or reverse takeover. We believe it would be helpful and aid clarity if this was set out specifically in Note 3 on Rule 21.2.

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

We welcome the amendments to Appendix 7. However, we would suggest more clarity in the following areas:-

1) Should the offeror's consent be required for the scheme timetable?

2) Where the board of the offeree company withdraws its recommendation and the offeror switches to a contractual offer, will the offer timetable start again?

3) We believe that the words "and elects not to implement the scheme" or similar should be added at the end of 3(d)(i) to cover the situation where an offeree company chooses to withdraw its recommendation as a result of an equally compelling competing offer being announced but does not recommend that competing offer as the board is seeking to put both the offers to the shareholders.

4) If either of the situations in 3(d) (ii) or (iii) occurs, should the offeror have the right to compel the offeree company board to announce a revised timetable? In situations where the adjournment does not prejudice the ability of the scheme to become effective, it seems draconian that the offeror's only remedy is to switch into an offer (and incur the related wasted costs and time delays with doing so). Alternatively, in the same circumstances should the offeror have to agree to the revised timetable?

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

We welcome the new Note 1 on Rule 25.2.

C: INCREASING TRANSPARENCY AND IMPROVING THE QUALITY OF DISCLOSURE

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

This is more onerous than the requirement under the Prospectus Rules for disclosure of fees and we do not believe that can be justified. We suggest that merely an aggregate figure for fees is required to be disclosed.

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 note that the wording of the new Rule 24.3(a)(vi) tracks LR 13.4.1 of the Listing Rules but it is not clear whether the Panel wants summary financial information or a description in words of the effect of full acceptance of the offer on "earnings and assets and liabilities". In the interests of clarity the Rule should set out how the Panel wants this information presented.

We take it that the Panel is not asking for summary financial information as that would take the form of a pro forma balance sheet and the Panel has decided that a pro forma balance sheet should not be required as it could be unduly onerous.

We query why the word "profits" has been deleted? It seems odd that disclosure is required of the effect of the offer on assets, liabilities and earnings but not profits?

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

We welcome this decision.

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

We support the decision to require more information on the financing of an offer. It would be useful to include a Note on Rule 24.2(f) clarifying that where the offeror is a newco vehicle, disclosures about financing should extend to the ultimate companies/people behind newco.

More guidance on disclosures as to headroom would be helpful. If a facility of "up to £x million" is secured (which includes headroom) and which will not all be drawn down if the offer is not increased, should the £x million figure be disclosed (but not described as "headroom") or can the offeror only disclose the amount which will be used to fund the offer at the initial offer price?

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

We query the statement in paragraph 6.34 of the consultation document about financing documents being put on display "without redaction". If these documents disclose any headroom secured, then surely they would need to be redacted?

D: PROVIDING GREATER RECOGNITION OF THE INTERESTS OF OFFEREE COMPANY EMPLOYEES

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

We welcome the amendments to this Rule.

However, we also have sympathy with the TUC comments made in their press release dated 21 March 2011 that "if takeovers are to be regulated in a way that really allows the impact on jobs, communities and the wider economy is to be considered it is essential that decision-making on these issues is not left in the hands of company shareholders alone."

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

The requirement that the statements must be adhered to for 12 months must be subject to material changes that could not have been envisaged eg severe change in economic climate and, depending on the business of the companies involved, other risk factors.

Should offerors be required to set out the risks factors that may lead to a change to their published intentions similar to those required to be disclosed in a prospectus?

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

The definition implies that an "employee representative" must be an existing representative, someone who has already been appointed. What about the situation where the company does not have an existing employee representative? It would be helpful to add that someone specifically appointed for the purposes of the offer would be included in the definition.

Pinsent Masons LLP

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