PCP 2012/2 - Response of the Takeovers Joint Working Party of the City of London Law Society Company Law Sub-Committee and the Law Society of England and Wales' Standing Committee on Company Law

Introduction

The Law Society of England and Wales is the representative body for solicitors in England and Wales. The City of London Law Society represents the professional interests of solicitors in the City of London who represent 15 per cent. of the profession in England and Wales.

Below are the views of the Takeovers Joint Working Party of the City of London Law Society Company Law Sub-Committee and the Law Society of England and Wales' Standing Committee on Company Law (the "Working Party") on the Panel Consultation Paper PCP 2012/2.

General comments

1. The stated aim of the PCP is to extend the provisions of the Code which currently apply to employee representatives so as to apply to the trustees of the offeree company's pension schemes.

2. The rights currently enjoyed by employee representatives are derived substantially from requirements imposed by the European Directive on Takeover Bids 2004/25/EC. There is no requirement in the Directive for member states to introduce similar, or indeed any, provisions in relation to the offeree company's pension scheme(s) or for the benefit of the pension scheme trustees (this is recognised in paragraph 2.3(a) of the PCP).

3. In our view, pension scheme trustees do not need these rights. Pension scheme trustees have been afforded specific protections under statute, creating a statutory regulatory regime which has been enhanced over time to strengthen the position of pension scheme trustees. In addition, we cannot see a justification as to why pension scheme trustees' rights should be different on a Code-governed transaction when compared to a private acquisition not subject to the Code. In our view, the proposed rights confer little or no benefit to offeree companies, offeree shareholders or the beneficiaries of the pension schemes in question but would bring additional regulatory burden and costs, which is not proportionate.

4. Furthermore, if there is a benefit to offeree shareholders or to the beneficiaries of the pension schemes in reading the opinions of the pension scheme trustees as proposed, how can those persons make an informed assessment of such opinions without understanding the rights that such pension scheme trustees have under the terms of such pension schemes. Such a regime would, in our view, not be proportionate. We believe that if pension scheme trustees are given these additional rights under the Code, they should themselves be required to disclose the terms of the pension schemes (i.e. the trust deeds of the schemes) so that it is clear what rights those trustees have and there is parity in disclosure.

5. Paragraph 2.5 of the PCP states that the key purpose of these proposals is to help to ensure that the effects of the offer on the pension schemes could be discussed by the relevant parties at an earlier stage, with the result that any issues which might arise as a consequence of the potential change of control of the company could then be considered by shareholders and the offeree company amongst others. If part of the aim of the PCP is to benefit the beneficiaries of pension schemes, we question whether in fact these proposed changes are correctly

targeted. They are more likely to serve to benefit the community of advisers to pension trustees (financial and legal) instead. Indeed, in adding further regulation and "protection" to pension schemes and therefore further regulatory burden and cost, the proposals along with other "protections" might add a cost which is ultimately passed onto the beneficiaries of the pension schemes and shareholders in the companies concerned (a point which the Kay review has commented on and criticised).

6. The impact of an offer on the pension scheme falls into two broad categories:

   (a) the impact of the offer on benefit accrual under the scheme, for example whether or not the offeror intends to change or cease benefits ("**benefit impacts**"); and

   (b) in the case of a defined benefit scheme, the impact of the financing of the offer on the creditworthiness of the target company and, in particular, the trustees' position as creditor of the target and its subsidiaries in relation to any deficit in the funding of the benefits ("**creditor impacts**").

   It is clear from the PCP that it is envisaged that the discussions would involve discussions as to both (a) and (b) but the draft Code additions seem aimed only at (a).

7. To the extent that the intention is to cover creditor impacts (ie (b)), we question the fundamental basis of the consultation. The Code is designed principally to protect shareholders in the offeree companies by ensuring that they are treated fairly, they have the opportunity to decide on the merits of the bid and that they are afforded equivalent treatment by an offeror. We question whether it is within the remit of the Code, or indeed the Panel, to protect creditors. If the Panel chooses to protect this class of creditor why not others? Why not depositors in takeovers of banks or why not policy holders in takeovers of life assurers or insurance companies? What of holders of unfunded contractual pension rights? We can see that creditor impacts that affect transaction certainty could be relevant to shareholders under the Code but not all creditor impacts have this effect and, for those that do, the existing regime provides suitable protection for trustees. We explain why the existing regime works in paragraph 9 below.

8. We think therefore that if any rights are to be extended to the trustees of the offeree company's pension scheme(s), such rights should be limited to rights to comment on benefit impacts.

9. Our experience is that where a takeover poses a risk to the creditworthiness of the target in terms of the pension scheme, and where the trustee powers are material to the bid (eg power to set contribution rates such as to reduce the deficit more quickly to mitigate the credit risk), the offeror will typically inform the trustees of the proposals at an early stage with a view to discussing the creditor problem and reaching a suitable agreement with the trustees. The principal reasons for this are:

   - to give the offeror some certainty as to employer contribution levels under the scheme's deficit recovery plan in the medium term (enabling more accurate pricing); and

   - where the takeover is being effected by a scheme of arrangement, to avoid the trustees of the pension scheme and/or the scheme members making representations at the court hearing.

   So where the pension scheme is "material" to the offeror or the bid (i.e. it affects transaction certainty), the current regime in practice does ensure that trustees are informed of a takeover

early so that the parties can discuss covenant and reach a suitable agreement where appropriate.

Where the pension scheme is not material to the offeror or the bid, the offeror is unlikely to involve the trustees of the scheme. These are situations where the scheme is small enough, or the offeror sufficiently well-funded, that any actions which the trustees might take as creditor do not affect the likelihood that the transaction will proceed. In that situation, we consider that trustees should not be given rights to comment on creditor impacts as this undermines the Code's primary objective of protecting shareholders.

If trustees are given general rights to comment on creditor impacts whether or not they affect transaction certainty, that would seem to be unfair to other creditors of the target who have no rights under the Code. But fundamentally, we would reiterate the point in paragraph 7 above that it is not within the remit of the Code or indeed the Panel to protect creditors.

10. Giving formal rights to trustees under the Code around creditor impacts, could also lead to the trustees feeling pressured into taking a more robust approach in their dealings with bidders so as to avoid criticism from members that they did not exercise their rights under the Code in a proper manner.

11. The impact on benefits is, in reality, limited to benefit accrual. There are statutory provisions (for instance section 67 of the Pensions Act 1995) and provisions under pension scheme documentation (such as restrictions under scheme's powers of amendment), that largely prevent deferred members' and pensioners' benefits from being reduced unless certain safeguards, (such as obtaining affected members' consents) are complied with. We therefore consider that if any rights are to be extended to the trustees of offeree company's pension schemes, any such rights should only extend to active members (and not deferreds and pensioners) as the rights currently available to employee representatives protect only current employees of the target company.

12. If the Code Committee decides not to exclude creditor impact from the proposals, we would suggest suitable clarificatory wording along the lines of:

> 'the offeror must state its intentions with regard to the future business of the offeree company and explain the long-term commercial justification for the offer. In addition, it must state… (iii) its intentions with regard to the offeree company’s pension scheme(s), and **any likely materially detrimental impact of the financing of the offer on funding or deficit recovery plans for any defined benefit pension scheme;**'

Responses to the specific questions raised in the PCP

Q1 Do you have any comments on the proposed amendments to Rules 24.2(a) and (b) relating to the requirement for an offeror to disclose, among other matters, its intentions with regard to the offeree company’s pension scheme(s)?

We think that the offeror should not have to comment on the impact on the scheme as a creditor of the offeree and the Code should make this clear. On that basis, these proposals should only be introduced insofar as they relate to future benefits of active members and the offeror's intentions to make any changes to those benefits.

Q2. Do you have any comments on the proposed amendments to Rule 25.2(a) relating to the requirement for the offeree board to include in the offeree board circular its views on,

among other matters, the effects of implementation of the offer on the offeree company's pension scheme(s)?

We think that the offeree should not have to comment on the impact on the scheme of the bidder being a creditor of the offeree and the Code should make this clear. On that basis, these proposals should only be introduced insofar as they relate to future benefits of active members and the offeror's intentions to make any changes to those benefits.

Q3. Do you have any comments on the proposed amendments to Rules 2.12(a), 2.12(b), 24.1, 25.1, 32.1, 32.6(a) and 27.1(b), and to Note 6 on Rule 20.1, in each case relating to the information to be disclosed to the trustees of an offeree company's pensions scheme(s)?

We agree that the trustees should receive these documents as they may contain statements relating to future benefits. However, these documents will not be sufficient to enable the trustees to ascertain the impact of the takeover on the creditworthiness of the offeree company. This reinforces our argument that creditor impacts should be excluded from the proposals. The documents that the trustees would require in order to comment on creditor impacts are often commercially confidential to the offeror (as they relate to its funding and structure) and there should be no requirement to make these available to the trustees.

Q4. Do you have any comments on the proposed amendments to Rule 25.9 (and Note 1 on that Rule) and to Rule 32.6 regarding the rights of the trustees of an offeree company's pension scheme(s) to make known their views on the effects of the offer on the scheme(s)?

We think that the views which the trustees should be invited to express should be limited to those relating to the impact on future benefits of active members and the offeror's intentions to make any changes to those benefits. There should be a power (though not an obligation) for the offeree to excise any part of the opinion which goes beyond this. The trustees should have no right to comment on the impact on the scheme as creditor of the offeree company and the propsoed changes to the Code should make this clear.

We agree that there is no need for a requirement to be introduced for the offeree to pay the cost incurred by the trustees in obtaining advice to support the information contained in the opinion.

Q5. Do you have any comments on the proposed amendments to Rule 2.12(d) and to Rule 32.1 regarding the requirement for the trustees of the offeree company's pension scheme(s) to be informed of their rights under the Code to make known the effects of the offer on the scheme(s)? Do you have any comments on the proposed amendment to Rule 19.2 relating to directors' responsibility statements?

We have no objection to this proposal so long as the opinion is restricted as suggested above.

Q6. Do you have any comments on the proposed new Rule 24.3(d)(xvi) and new Rule 26.2(i) relating to the requirement for the offer document to include a summary of any agreement between the offeror and the offeree company's employee representatives or the trustees of the offeree company's pension scheme(s) in relation to any of the matters

described in Rule 24.2 and to the requirement for any such agreement(s) to be put on display?

We do not think this is sensible. If an agreement has been reached with the trustees on mitigation for the impact on the scheme as creditor of the target, that will have been reached against the background of the offeror's existing financing and group structure, its proposed acquisition financing (and, if known, its long term financing for the target) and possible proposals for restructuring the target group post transaction. Some of this information may not be public and some may be subject to duties of confidentiality to third parties. It would be possible in many cases to deduce aspects of the financing from the agreement that has been reached with the trustees (for example trustees often seek to mirror negative pledges in financing documents or otherwise obtain pari passu treatment). There should not, therefore, be an obligation either to summarise the agreement or make it public unless that is a term of the agreement with the trustees.