

PCP 13 Issued on 30 April 2003

**THE PANEL ON TAKEOVERS AND MERGERS**

**CONSULTATION PAPER ISSUED BY  
THE CODE COMMITTEE OF THE PANEL**

**TREASURY SHARES**

**REVISION PROPOSALS RELATING TO THE  
DEFINITIONS OF THE TAKEOVER CODE AND  
THE SARS AND TO NOTE 7 ON RULE 21.1**

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

The Code Committee is therefore inviting comments on this Consultation Paper. Comments should reach the Code Committee by 11 June 2003.

Comments may be sent by email to:

[consultation@disclosure.org.uk](mailto:consultation@disclosure.org.uk)

Alternatively, please send comments in writing to:

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

# TREASURY SHARES

## 1. Introduction

### Background

1.1 In September 2001, the DTI published a consultative document on treasury shares (“the Consultative Document”). This document invited comments on the draft Companies (Acquisition of Own Shares) (Treasury Shares) Regulations (“the Regulations”) which would, for the first time, permit companies to hold certain types of shares “in treasury” for resale at a later date. On 31 May 2002, the DTI published a summary of the responses to the Consultative Document and, on 15 April 2003, the Regulations were laid before Parliament. The Regulations will come into force on 1 December 2003.

### Features of Treasury Shares

1.2 Under existing company law, public and private companies are, subject to certain restrictions and safeguards, permitted to purchase their own shares provided that such shares are immediately cancelled on purchase. When the Regulations come into force, public companies will, subject to certain restrictions, be permitted to hold “qualifying shares” in treasury. Qualifying shares are principally shares which are quoted on the Official List of the London Stock Exchange or are admitted to trading on AIM. Accordingly, following the introduction of the Regulations, public companies will be able to purchase their own shares and either cancel such shares or retain them in treasury for resale at a future date. Treasury shares will also be able to be transferred (i.e. without money changing hands) for the purpose of, or pursuant to, an employees’ share scheme. It is anticipated that this will provide additional flexibility to companies in managing their capital structures and that the sale of shares from treasury will be utilised particularly in order to satisfy the exercise of employee share options.

- 1.3 Under the Regulations, treasury shares have the following characteristics:
- (a) because treasury shares are not cancelled, they continue to have a nominal value and to form part of the company's issued share capital;
  - (b) for so long as they are held in treasury, the voting rights in respect of the shares are suspended;
  - (c) for so long as they are held in treasury, the dividend and distribution rights in respect of the shares are also suspended (although treasury shares will participate in bonus issues);
  - (d) there is a limit on the number of shares which may be held in treasury: no more than 10% of the nominal value of the issued share capital of the company at any one time (or, if appropriate, 10% of the relevant class of the issued share capital) may be held in treasury;
  - (e) a company may only sell shares from treasury for cash (as defined in the Regulations) or transfer them for the purposes of, or pursuant to, an employees' share scheme and the sale of shares from treasury will be subject to similar pre-emption rights in favour of the company's existing shareholders as apply on an issue of new shares for cash. However, the pre-emption rights will be subject to the same dispensation as applies in respect of an issue of new shares for cash, namely that they may be disapplied if approved by special resolution of the company's shareholders; and
  - (f) the 90% threshold required to be triggered in order to invoke the compulsory acquisition provisions contained in Sections 428 to 430F of the Companies Act 1985 will be calculated by reference to the shares in issue outside treasury. Accordingly, there will be no need for treasury shares to be subject to an offer. Once the 90% threshold has been reached and the offeree company has been notified of that fact by

the offeror, subsequent sales of shares from treasury by the offeree company are prohibited except to the offeror.

## 2. Proposed Amendments to the Code and the SARs

### Principal Amendments

2.1 Subject to certain consequential amendments which are described below, the Code Committee believes that the principal changes which need to be made to the Code and the SARs to take account of the introduction of treasury shares are as follows:

- (a) an explanation that, for the purposes of the Code and the SARs, it is only shares held and in issue outside treasury which are relevant. The Code Committee believes that this is appropriate because, as explained above, the rights attaching to the shares (save for the right to participate in a bonus issue) are suspended for as long as the shares are held in treasury. As a result, the Code Committee considers that in calculating percentage holdings of voting rights, share capital and relevant securities, shares held in treasury are to be ignored. This should be achieved by amending the Definitions in the Code to include a new provision relating to treasury shares as follows:

***“Treasury shares***

*All percentage holdings of voting rights, share capital and relevant securities are to be calculated by reference to the relevant percentage held and in issue outside treasury.”*

A similar amendment will also need to be made to the SARs save that, in the case of the SARs, it will not be necessary to make reference to “relevant securities” as this term is only used in the Code (principally in the context of the dealing disclosure requirements set out in Rule 8).

The Code Committee considered whether any amendment also ought to be made to the definition of voting rights. The Code Committee concluded that this was not necessary as the definition of voting rights in the Code and the SARs already refers to “all the voting rights attributable to the share capital of a company which are currently exercisable at a general meeting”. Accordingly, given that the voting rights attaching to shares are suspended while they are held in treasury, the definition is already clear that it is only shares carrying voting rights held and in issue outside treasury which are relevant; and

- (b) an explanation that, for the purposes of the Code and the SARs, a transfer of shares out of treasury will normally be treated in the same way as an issue of new shares. Accordingly, by way of example, the board of an offeree company will generally be prohibited under Rule 21.1 from transferring shares out of treasury during the course of an offer or if it has reason to believe that a bona fide offer might be imminent, without the approval of shareholders in general meeting. It will also normally be possible to obtain a Rule 9 whitewash of a transfer of shares from treasury if the acquisition of such shares would otherwise result in a mandatory bid obligation being triggered.

The Code Committee believes that this should be achieved by including an additional sentence to the new provision in the Definitions relating to treasury shares in the following terms:

*“A transfer of shares by a company from treasury will normally be treated in the same way as an issue of new shares.”*

An identical amendment will also need to be made to the new provision relating to treasury shares in the Definitions of the SARs.

However, in the opinion of the Code Committee, there may be cases where it would not be appropriate to treat a transfer of shares from

treasury in the same way as an issue of new shares. By way of example, the acquisition by an offeror of new shares in the offeree company would not normally have consequences under Rule 6 or Rule 11. This is because, where new shares are acquired, no existing shareholder in the offeree company benefits by exiting his shareholding at the hands of the offeror. As a result, the fundamental principle which underpins Rules 6 and 11, namely that all shareholders in the offeree company are treated equally by an offeror, is not offended.

However, the Code Committee understands that it may be possible for a company to transfer shares from treasury directly on to an electronic order book on which its shares are traded, such as SETS. Where shares are purchased off the order book, the identity of the vendor is not disclosed and so an offeror could purchase such shares without realising that they were transferred from treasury. In such circumstances, the Code Committee does not believe that it would be appropriate for an offeror to escape an obligation that would otherwise arise under Rule 6 or Rule 11 because it has subsequently (and fortuitously) discovered that the shares which it has purchased were in fact treasury shares. As a result, the Code Committee believes that it is important that the word “normally” is included in the new provision contained in the Definitions.

**Q1 Do you agree that the Definitions in the Code and the SARs should be amended in the manner suggested to take account of the introduction of treasury shares?**

#### Consequential Amendments

##### *Disclosure Obligations*

2.2 In the Consultative Document, the DTI stated that all transfers of shares in and out of treasury, and the cancellation of shares held in treasury, should be

required to be disclosed to the market under the appropriate rules regulating the market in question, together with the resultant total of shares held in treasury following the transaction. The DTI proposed that this obligation should mirror the requirement contained in paragraph 15.9 of the Listing Rules for companies to disclose details of purchases of their own shares (including the number of shares purchased and the price paid) as soon as possible and in any event by 7.30am on the business day following the calendar day on which the dealing took place.

- 2.3 In the light of this, and following discussions with the UKLA and the AIM Team at the London Stock Exchange, the Code Committee understands that appropriate amendments will be made to the Listing Rules and the AIM Rules to require the prompt public disclosure of transfers of shares into and out of treasury and of the cancellation of shares held in treasury. As a result, the Code Committee does not consider that it is necessary for any amendment to be made to the Code or the SARs to require the disclosure of such transactions.

**Q2 Do you agree that no amendment needs to be made to the Code or to the SARs to require the disclosure of transfers of shares into and out of treasury and of the cancellation of shares held in treasury?**

*Dealing Disclosure Forms*

- 2.4 In the light of the proposed amendment set out in paragraph 2.1(a) above, the Code Committee believes that it is important that a Note is included on the dealing disclosure forms to make clear that, in calculating the resultant total percentage holding of voting rights or of the class of relevant security, shares held in treasury are to be ignored.

- 2.5 By way of background:

(a) when a company is in an offer period, any dealings by an associate of an offeror or of the offeree company in relevant securities of the



offeree company (and, in the case of a securities exchange offer, in relevant securities of the offeror) must be publicly disclosed under Rule 8 by no later than 12.00 noon on the business day following the date of the dealing. Likewise, any person who owns 1% or more of any class of relevant securities of an offeror or of the offeree, or as a result of a transaction will so own 1% or more, must disclose any dealings in such securities in the same way; and

- (b) whether or not a company is in an offer period, Rule 3 of the SARs requires any person who acquires shares in a company which takes his aggregate holding of voting rights or rights over shares to 15% or more, or if his holding of voting rights or rights over shares is already 15% or more and as a result of the acquisition is increased to or beyond any whole percentage figure, to disclose publicly that acquisition by no later than 12.00 noon on the business day following the date of the dealing. In addition, under Rule 5 of the SARs, the holdings of persons acting by agreement or understanding must be aggregated for the purposes of the SARs (including the disclosure obligation under Rule 3) and, under Note 3 on Rule 5, where the aggregate holding of voting rights or rights over shares is between 15-30% of the voting rights of a company, disposals resulting in the aggregate holdings of shares and rights over shares decreasing below any whole percentage level must be notified to the company as if such persons had an agreement to which Section 204 of the Companies Act 1985 applies.

In each case, the resulting total percentage holding following the dealing must be publicly disclosed.

2.6 For the sake of clarity, the Code Committee believes that the disclosure forms should be amended as follows:

- (a) Rule 8.1/8.3 disclosure form: include a new Note 1 (and re-number the existing Notes 1-6 accordingly) in the following terms:

*“Note 1. The resultant total percentage holding of the class of relevant security is to be calculated by reference to the percentage held and in issue outside treasury.”*

- (b) Forms SAR 3 and SAR 5: re-number the existing Note as Note 1 and include a new Note as Note 2 in the following terms:

*“Note 2. The resultant total percentage holding of voting rights and rights over shares is to be calculated by reference to the percentage held and in issue outside treasury.”*

**Q3 Do you agree that the dealing disclosure forms should be amended in the manner suggested?**

*Note 13 on Rule 8*

- 2.7 The Code Committee also believes that a similar amendment should be made to Note 13 on Rule 8. Accordingly, the Code Committee proposes that Note 13 should be amended as set out below:

*“13. Companies Act 1985*

*In addition to the requirements to disclose under Rule 8, the requirements of Part VI of the Companies Act 1985 as to disclosure of interests may be relevant. It is likely that, where disclosure is necessary under that Act in respect of a notifiable interest in shares and a dealing occurs during an offer period, disclosure will also be necessary under Rule 8.3. It should be noted that the 1% threshold for the purpose of Rule 8.3 is to be calculated by reference to the percentage of the class of relevant security held and in issue outside treasury – see the reference to treasury shares in the Definitions.”*

**Q4 Do you agree that Note 13 on Rule 8 should be amended in the manner suggested?**

*Note 16 on Rule 9.1*

- 2.8 The Code Committee does not believe that a person who has incurred an obligation to make a mandatory bid under Rule 9 should be required to extend the offer to shares held in treasury. This is because, although treasury shares continue to form part of a company's issued share capital, all the rights attaching to the shares are suspended for so long as they are held in treasury (save for the limited right to participate in a bonus issue). Furthermore, under the Regulations, the right to invoke the compulsory acquisition provisions contained in the Companies Act is to be triggered by reference to 90% of the shares to which the offer relates (or, if appropriate, 90% of the shares of any class to which the offer relates) "excluding any shares in the company held as treasury shares" (Section 429(1) of the Companies Act, as amended by paragraph 26 of the Schedule to the Regulations).
- 2.9 The Code Committee believes that this amendment should be achieved by including a new Note on Rule 9.1 in the following terms:

*"16. Treasury shares*

*When an obligation to make an offer is incurred under this Rule, it is not necessary for the offer to extend to shares in the offeree company held in treasury."*

**Q5 Do you agree with the proposed new Note 16 on Rule 9.1?**

*Note 3 on Rule 10*

- 2.10 Note 3 on Rule 10 imposes an obligation on an offeree company, following the announcement of the firm intention to make an offer for it, to provide the offeror with all relevant details of its issued share capital and of all conversion or subscription or any other rights pursuant to the exercise of which shares may be issued during the offer period.

- 2.11 The Code Committee believes that Note 3 should be amended to require an offeree company to provide the offeror with details of the extent to which any of its issued share capital is held in treasury. The Code Committee believes that this should be achieved by amending the first sentence of Note 3 as set out below:

*“Following the announcement of a firm intention to make an offer, the offeree company must, on request, provide the offeror as soon as possible with all relevant details of the issued shares (including the extent to which any such shares are held in treasury) and, to the extent not issued, the allotted shares and details of any conversion or subscription rights or any other rights pursuant to the exercise of which shares may be unconditionally allotted or issued during the offer period.”*

**Q6 Do you agree that Note 3 on Rule 10 should be amended in the manner suggested?**

*Note 7 on Rule 21.1*

- 2.12 As explained above, it is anticipated that one of the purposes for which treasury shares will be utilised will be in order to satisfy the exercise of employee share options. Accordingly, as an alternative to, or possibly instead of, satisfying obligations arising on the exercise of employee share options through either the issue of new shares or the transfer of shares previously acquired by an employee benefit trust, a company may decide to meet this commitment by transferring shares out of treasury.
- 2.13 However, under Rule 21.1(a), if the company is subject to an offer or if the board of the offeree company has reason to believe that a bona fide offer might be imminent, it will not be possible to meet this obligation through the issue of new shares, or if the proposed reference to treasury shares in the Definitions is adopted, through the transfer of shares from treasury, unless either shareholders’ approval or the offeror’s consent is obtained. As a result,

the company is obliged to purchase shares in the market to meet this commitment.

- 2.14 The Code Committee does not believe that the Code should prohibit the issue of new shares, or the transfer of shares from treasury, in such circumstances. This is because, following the exercise of share options, the company has a contractual commitment to provide a corresponding number of shares to the employee which commitment will have predated the commencement of the offer period and/or the approach from the offeror. Accordingly, the issue of shares in these circumstances cannot be said to be action which was taken by the board of the offeree company with a view to frustrating an offer or potential offer and, as such, is not offensive under Rule 21.1 or General Principle 7. As a result, the Code Committee proposes that a second sentence should be added to the existing Note 7 on Rule 21.1 as follows:

*“7. Established share option schemes*

*Where the offeree company proposes to grant options over shares, the timing and level of which are in accordance with its normal practice under an established share option scheme, the Panel will normally give its consent. Likewise, the issue of new shares to satisfy the exercise of share options will not normally be prohibited by this Rule.”*

If the proposed reference to treasury shares in the Definitions is adopted, this amendment will also permit the exercise of employee share options to be satisfied by the transfer of shares from treasury.

- Q7 Do you agree that Note 7 on Rule 21.1 should be amended in the manner suggested?**

*Rules 37.3(c) and 37.4(b)*

- 2.15 Rule 37.3(c) requires that the offeree board circular advising shareholders on an offer must disclose details of any purchases by the company of its own

shares in the period commencing 12 months prior to the offer period and ending with the latest practicable date prior to the posting of the document. Rule 37.4(b) imposes a similar obligation on an offeror in the context of a securities exchange offer to disclose details of any purchases of its own shares in the offer document.

- 2.16 The Code Committee believes that Rules 37.3(c) and 37.4(b) should be amended to require disclosure of the extent to which shares repurchased by the offeree company or the offeror respectively during the relevant period were either immediately cancelled or were retained in treasury. Accordingly, the Code Committee proposes to amend Rule 37.3(c) as follows:

*“The offeree board circular advising shareholders on an offer must state the amount of relevant securities of the offeree company which the offeree company has redeemed or purchased during the period commencing 12 months prior to the offer period and ending with the latest practicable date prior to the posting of the document, and the details of any such redemptions and purchases, including dates and prices and the extent to which the shares redeemed or purchased were cancelled or held in treasury.”*

A similar amendment will also be made to the end of Rule 37.4(b).

- Q8 Do you agree that Rules 37.3(c) and 37.4(b) should be amended in the manner suggested?**

*Other amendments*

- 2.17 As referred to in PCP 14, which has been published at the same time as this PCP, the Code Committee is proposing to introduce a new Rule 2.10 to require offeror and offeree companies to announce details of their relevant securities in issue at the commencement of an offer period. As explained in PCP 14, the Code Committee proposes that there should be a Note on the new Rule, to be included as Note 2 on Rule 2.10, in the following terms:

“2. *Treasury shares*

*Only relevant securities which are in issue and held outside treasury should be included in the announcement.”*

2.18 The Code Committee believes that the proposed amendments to the Definitions set out in paragraph 2.1 above address clearly and concisely the issues which arise on the application of the Code and the SARs following the introduction of treasury shares. In the opinion of the Code Committee, it is preferable to restrict the changes to the Code and the SARs to these simple amendments (and to the few consequential amendments referred to above) rather than to make multiple minor amendments. As a result, the Code Committee does not believe that it is necessary to make any other amendments to the Code or the SARs to cater for the introduction of treasury shares beyond those set out above.

2.19 The Code Committee does not believe that these proposals would result in any additional costs to either companies or their shareholders.

2.20 Appendix II sets out the relevant provisions of the Code and the SARs as they will be if the changes proposed in this PCP are adopted. If adopted, the Code Committee proposes that all the amendments referred to in Appendix II will come into effect at the same time that the Regulations come into force (i.e. 1 December 2003).

**Q9 Do you agree that only the amendments proposed should be made to the Code and to the SARs to take account of the introduction of treasury shares?**

**APPENDIX I – LIST OF QUESTIONS**

- Q1** Do you agree that the Definitions in the Code and the SARs should be amended in the manner suggested to take account of the introduction of treasury shares?
- Q2** Do you agree that no amendment needs to be made to the Code or to the SARs to require the disclosure of transfers of shares into and out of treasury and of the cancellation of shares held in treasury?
- Q3** Do you agree that the dealing disclosure forms should be amended in the manner suggested?
- Q4** Do you agree that Note 13 on Rule 8 should be amended in the manner suggested?
- Q5** Do you agree with the proposed new Note 16 on Rule 9.1?
- Q6** Do you agree that Note 3 on Rule 10 should be amended in the manner suggested?
- Q7** Do you agree that Note 7 on Rule 21.1 should be amended in the manner suggested?
- Q8** Do you agree that Rules 37.3(c) and 37.4(b) should be amended in the manner suggested?
- Q9** Do you agree that only the amendments proposed should be made to the Code and to the SARs to take account of the introduction of treasury shares?



## APPENDIX II

### Amendments to the Code

#### Amendment to the Definitions

##### **“Treasury shares**

All percentage holdings of voting rights, share capital and relevant securities are to be calculated by reference to the relevant percentage held and in issue outside treasury. A transfer of shares by a company from treasury will normally be treated in the same way as an issue of new shares.”

#### New Note 2 on Rule 2.10

##### *“2. Treasury shares*

*Only relevant securities which are in issue and held outside treasury should be included in the announcement.”*

#### Amendment to the Rule 8.1/8.3 disclosure form

*“Note 1. The resultant total percentage holding of the class of relevant security is to be calculated by reference to the percentage held and in issue outside treasury.”*

#### Amendment to Note 13 on Rule 8

##### *“13. Companies Act 1985*

*In addition to the requirements to disclose under Rule 8, the requirements of Part VI of the Companies Act 1985 as to disclosure of interests may be relevant. It is likely that, where disclosure is necessary under that Act in respect of a notifiable interest in shares and a dealing occurs during an offer period, disclosure will also be necessary*

*under Rule 8.3. It should be noted that the 1% threshold for the purpose of Rule 8.3 is to be calculated by reference to the percentage of the class of relevant security held and in issue outside treasury – see the reference to treasury shares in the Definitions.”*

New Note 16 on Rule 9.1

*“16. Treasury shares*

*When an obligation to make an offer is incurred under this Rule, it is not necessary for the offer to extend to shares in the offeree company held in treasury.”*

Amendment to Note 3 on Rule 10

*“Following the announcement of a firm intention to make an offer, the offeree company must, on request, provide the offeror as soon as possible with all relevant details of the issued shares (including the extent to which any such shares are held in treasury) and, to the extent not issued, the allotted shares and details of any conversion or subscription rights or any other rights pursuant to the exercise of which shares may be unconditionally allotted or issued during the offer period.”*

Amendment to Note 7 on Rule 21.1

*“7. Established share option schemes*

*Where the offeree company proposes to grant options over shares, the timing and level of which are in accordance with its normal practice under an established share option scheme, the Panel will normally give its consent. Likewise, the issue of new shares to satisfy the exercise of share options will not normally be prohibited by this Rule.”*

Amendment to Rule 37.3(c)

**“The offeree board circular advising shareholders on an offer must state the amount of relevant securities of the offeree company which the offeree company has redeemed or purchased during the period commencing 12 months prior to the offer period and ending with the latest practicable date prior to the posting of the document, and the details of any such redemptions and purchases, including dates and prices and the extent to which the shares redeemed or purchased were cancelled or held in treasury.”**

Amendment to Rule 37.4(b)

**“The offer document must state (in the case of a securities exchange offer only) the amount of relevant securities of the offeror which the offeror has redeemed or purchased during the period commencing 12 months prior to the offer period and ending with the latest practicable date prior to the posting of the offer document and the details of any such redemptions and purchases, including dates and prices and the extent to which the shares redeemed or purchased were cancelled or held in treasury.”**

### **Amendments to the SARs**

Amendment to the Definitions

#### **“Treasury shares**

All percentage holdings of voting rights and share capital are to be calculated by reference to the relevant percentage held and in issue outside treasury. A transfer of shares from treasury will normally be treated in the same way as an issue of new shares.”

Amendment to Form SAR3 and Form SAR5

*“Note 2. The resultant total percentage holding of voting rights and rights over shares is to be calculated by reference to the percentage held and in issue outside treasury.”*