

**PCP 2004/4 Issued on 10 August 2004**

**THE PANEL ON TAKEOVERS AND MERGERS**

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

**CONDITIONS AND PRE-CONDITIONS**

**REVISION PROPOSALS RELATING TO  
RULES 2.4, 2.5, 2.7, 9.3, 13, 23, 24.6, 34, 35.1 and 38.3  
OF THE TAKEOVER CODE**

Before it introduces or amends any Rules of the Takeover Code or the Rules Governing Substantial Acquisitions of Shares, the Code Committee of the Takeover Panel is normally 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 **29 October 2004**.

Comments may be sent by email to:

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

Alternatively, please send comments in writing to:

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The Panel on Takeovers and Mergers  
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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.

## **1. INTRODUCTION**

- 1.1 It is standard market practice in the UK for offers (other than mandatory offers, where the provisions of Rule 9 apply) to be stated as being conditional upon the satisfaction or waiver of a number of conditions. The principal Rule of the City Code on Takeovers and Mergers (the “Code”) dealing with such conditions is Rule 13. On occasion, an offeror might also seek to announce an offer the making of which is subject to the satisfaction or waiver of one or more pre-conditions.
- 1.2 The Code Committee has been considering the Code’s application to offer conditions and pre-conditions and this paper seeks views on the approach (which includes amendments to the Code, as set out in Appendix A) that the Panel should adopt in relation to these matters in the future.

## **2. OFFER CONDITIONS**

As mentioned above, voluntary offers in the UK will usually be stated as being subject to a number of conditions. In a typical offer, the conditions can be broken down into four broad categories, as follows:

- the acceptance condition - i.e. the minimum level of shareholder acceptance of the offer below which the offeror may decline to proceed with the offer. Under Rule 10 of the Code, it must be a condition of any voluntary offer (other than a partial offer under Rule 36) that the offeror has acquired or agreed to acquire more than 50 per cent. of the voting rights of the offeree company. Usually, the acceptance condition will be set at 90 per cent. of the offeree company shares offered for in order then to allow the offeror to invoke the Companies Act compulsory acquisition procedures, although the drafting of the condition will almost invariably allow the offeror to waive this threshold down to the minimum permitted by Rule 10;

- OFT/Competition Commission or European Commission clearances. Under Rule 12 of the Code, it must be a term of any offer which falls for possible referral to the Competition Commission or consideration by the European Commission that it will lapse if there is a reference or the initiation of proceedings before the later of the first closing date and the date the offer becomes or is declared unconditional as to acceptances. In practice, most offers also include a waivable condition relating to OFT/Competition Commission or European Commission clearance, as appropriate;
- other, effectively mandatory, conditions designed to give effect to some supervening statutory or regulatory requirement. For example, a listing condition or a condition relating to shareholder approval where the offer is a Class 1 transaction for the offeror under the UKLA's Listing Rules; and
- “protective conditions” - i.e. other conditions included for the benefit of a party in order to give that party the right not to proceed with the offer in the circumstances stipulated. Protective conditions are most often included for the benefit of the offeror, although less frequently (and generally only on securities exchange offers) they might also be included for the benefit of the offeree company/offeree company shareholders (referred to as “offeree protection conditions”). Offeree protection conditions are discussed in more detail in Section 9 below.

### **3. THE CODE'S TREATMENT OF CONDITIONS**

- 3.1 The announcement of a firm offer will inevitably have a profound effect upon the offeree company and the market price of its shares. While investors in a company which is the subject of an offer appreciate that it may fail due to lack of acceptances or due to competition or other regulatory problems, they expect that the offer will only be withdrawn for other reasons in a small minority of cases.

3.2 To reflect this, the Code attempts to reduce to a minimum the number of offers that are withdrawn by placing upon offerors and their financial advisers an obligation to exercise due care before making an offer. General Principle 3 of the Code provides that:

**“An offeror should only announce an offer after the most careful and responsible consideration. Such an announcement should be made only when the offeror has every reason to believe that it can and will continue to be able to implement the offer: responsibility in this connection also rests on the financial adviser to the offeror.”**

3.3 In this context, the inclusion of conditions in Code offers raises particular concerns. The Code Committee believes that the normal assumption should be that shareholders and the market expect that protective conditions will not be invoked. Further, they also expect that an offeror will not seek to use the invocation of a statutory/regulatory condition as a device to lapse its offer when it is unable to invoke any other condition. However, unless and except to the extent that such freedom is constrained by the Code, a condition to an offer may be invoked or waived by, and in the sole discretion of, the party for whose benefit it is included. Similarly, absent any overriding Code requirement, the ability to invoke a condition will depend exclusively on the drafting and proper interpretation of the condition concerned.

3.4 There is, therefore, clear tension between the inclusion of conditions to offers and the certainty that might be expected by shareholders and the market after a firm offer announcement.

3.5 As a result, the Code includes certain specific provisions designed to limit the ability of an offeror following announcement of a firm offer to withdraw or lapse the offer in reliance upon the failure of a condition, as follows:

- under Rule 2.5(a), which reiterates General Principle 3, the announcement of a firm intention to make an offer should be made only when the offeror

has every reason to believe that it can and will continue to be able to implement the offer;

- under Rule 2.7, following the making of a firm offer announcement under Rule 2.5, the offeror is normally required to proceed with posting the offer document and cannot withdraw unilaterally;
- under Rule 13, offer conditions may not normally be couched in subjective terms. This prohibition extends to conditions which, while apparently objective, are drawn so widely that they are in practice subjective. For example, a waivable acceptance condition requiring acceptances from 100 per cent. of shareholders would not be acceptable because the remote possibility of it being satisfied on its terms effectively vests sole discretion over withdrawal of the offer in the hands of the offeror (and also because there is no legitimate reason for requiring such a condition, given that the Companies Act compulsory acquisition procedures can be invoked once 90 per cent. of the shares offered for are acquired); and
- under Note 2 on Rule 13, an offeror will only be able to invoke a condition if “the circumstances which give rise to the right to invoke the condition are of material significance to the offeror in the context of the offer”. This is a fundamental provision of the Code which is designed to override the legal and contractual effect of offer conditions and is the primary protection against widely-drafted conditions being invoked contrary to the reasonable expectations of offeree company shareholders and the market generally. However, Note 2 on Rule 13 expressly provides that it does not apply to the acceptance condition or to UK and EC competition conditions. In addition, Note 2 does not apply in practice to other conditions required to give effect to some overriding statutory or regulatory requirement necessary to implement the offer or to issue any consideration securities under the terms of the offer, for example a listing condition or a Class 1 shareholder approval condition (or a similar condition in another jurisdiction).

3.6 The combination of these provisions therefore provides a high level of certainty following the announcement of a firm offer. The Code Committee believes that this is a key feature of the takeover landscape in the UK and that it provides a basis for the establishment of expectations among shareholders and the market according to a settled and well understood standard.

#### **4. APPLICATION OF NOTE 2 ON RULE 13**

##### **(a) *Practice Statement No. 5***

4.1 As mentioned above, Note 2 on Rule 13 establishes a threshold of materiality for the invocation of offer conditions which is designed to override the freedom that the offeror might otherwise have as a matter of contract and the legal construction of those conditions to withdraw its offer. Note 2 on Rule 13 provides as follows:

*“2. Invoking conditions*

*An offeror should not invoke any condition so as to cause the offer to lapse unless the circumstances which give rise to the right to invoke the condition are of material significance to the offeror in the context of the offer. The acceptance condition, and any condition included pursuant to Rule 12.1(c), are not subject to this provision.”*

4.2 The meaning of Note 2 on Rule 13 was considered by the Panel on appeal during the offer for Tempus Group plc by WPP Group plc, as reported in Panel Statement 2001/15. In that case, the condition in question on which the offeror sought to rely was a material adverse change (or “MAC”) condition. The Panel concluded that the necessary test of “material significance” was not met on the facts and in its decision stated that:

*“... meeting this test [i.e. Note 2 on Rule 13] requires an adverse change of very considerable significance striking at the heart of the purpose of the*

transaction in question, analogous ... to something that would justify frustration of a legal contract.”

4.3 The Code Committee understands that certain practitioners interpreted these words in Panel Statement 2001/15 to mean that an offeror would need to demonstrate legal frustration in order to be able to invoke a condition to its offer. The Code Committee notes that, as a result, the Panel Executive recently published Practice Statement No. 5 explaining that it does not consider this interpretation to be correct and that, in applying Note 2 on Rule 13 in the light of the Panel’s decision set out in Statement 2001/15, the Executive’s practice is as follows:

- as set out in Note 2, the appropriate test for the invocation of a condition under Rule 13 is whether the relevant circumstances upon which the offeror is seeking to rely are of material significance to it in the context of the offer – which must be judged by reference to the facts of each case at the time the relevant circumstances arise;
- in the case of a MAC, or similar, condition, whether the above test is satisfied will depend on the offeror demonstrating that the relevant circumstances are of very considerable significance striking at the heart of the purpose of the transaction; and
- whilst the standard required to invoke such a condition is therefore a high one, the test does not require the offeror to demonstrate frustration in the legal sense.

**(b) *Negotiated/Bespoke conditions***

4.4 In most offers, the conditions will follow a reasonably standard format in which the conditions are drafted in very wide terms and, even in recommended offers, they will often have been subject to little, if any, real



negotiation. This does not raise particular concerns under the Code, however, given the overriding application of Note 2 on Rule 13.

4.5 On some offers, though, an offeror might want to include certain more bespoke conditions, for example:

- a condition that the “net debt” of the offeree company does not exceed a particular amount; or
- if the offeree company is a property investment company, a condition that no event occurs (such as an act of terrorism) as a result of which a particular percentage of the portfolio is rendered unoccupiable for a particular period of time.

4.6 In a recommended offer, the terms of such bespoke conditions might often be the subject of keen negotiation to reflect the offeree company’s view of materiality and appropriateness. On occasion, the subject matter of a condition might also be within the clear and sole control of the offeree company – for example, a condition that the offeree company does not make any acquisitions or disposals of a value in excess of a particular amount.

4.7 The Code Committee has been considering whether such “bespoke” or “negotiated” conditions should continue to be subject to Note 2 on Rule 13 in the same way as the more standard, widely-drafted conditions, or whether a different, or even no, standard of materiality for the invocation of such conditions should apply.

4.8 In considering this issue, the Code Committee recognises that it might be argued that the Code’s usual, restrictive approach to the invocation of conditions as described above dates from a time when the structure of bids tended to be simpler, fewer bids took longer than the normal 60 day offer timetable and offerors were more prepared to be exposed to event risk during the offer period. In favour of not applying Note 2 on Rule 13 to bespoke or

negotiated conditions, or of applying a lower standard of materiality, it might also be argued that:

- if an offeror is on risk to acquire the offeree company, then it should be entitled to some protection in the interim against changes in the business or acts of the incumbent management, especially where it has identified the matter in advance as being of significance to it;
- in a recommended situation, the condition concerned can be expected to have been the subject of negotiation with the offeree company and can be expected to reflect its views on materiality and whether the condition is fair in the context of the offer;
- an offeror might be willing to pay more if it were afforded greater protection (or might not bid at all unless it is) and, on a recommended deal, allowing the offeree company to negotiate conditions outside the usual constraints of Note 2 would enable it to obtain the best possible price for its shareholders; and
- it should be possible to bring to the attention of offeree company shareholders and the market that certain conditions will not be subject to the full rigours of Note 2 on Rule 13 and, therefore, shareholders and the market should be on clear notice as to the circumstances in which the offer might not proceed.

4.9 On the other hand, the application of Note 2 on Rule 13 is a key feature of the UK takeover regime and clearly distinguishes UK public takeovers from both private transactions and public takeovers in a number of other jurisdictions. In favour of continuing to apply Note 2 to such bespoke or negotiated conditions, it might be argued as follows:

- any relaxation of the Note 2 regime would seriously dilute the high level of certainty that normally applies following the announcement of a firm

offer. The predictable and readily understood regime that currently applies for the invocation of conditions causing an offer to lapse would be undermined and shareholders, the market and, indeed, the parties to an offer and their advisers would need to analyse the detailed drafting of those conditions falling outside the ambit of Note 2 in order properly to understand the circumstances in which an offer might fail. It is unrealistic to expect that any other than the most sophisticated shareholders will be in a position to make such assessments, so it is arguable that the risks involved cannot adequately be dealt with simply by disclosure;

- allowing conditions which are not subject to Note 2 on Rule 13 (whether on a recommended deal or otherwise) means that the Panel would not be in a position to be the arbiter of whether a particular matter giving rise to the right to invoke a condition was of sufficient materiality that the offeror should be allowed to lapse its offer, taking into account all the circumstances; and
- it is unrealistic to expect the offeree company routinely to be able to exact a higher price from an offeror as the quid pro quo for agreeing to greater conditionality on a recommended transaction (not least because in practice the offer price is usually agreed separately from the conditions).

(c) *The Code Committee's conclusions*

4.10 Having considered these arguments, the Code Committee recognises that there might be situations in which an offeror would not be prepared to make an offer in the UK if it were not able to benefit from greater freedom in relation to the stipulation and invocation of conditions, without interference from the Panel, than is currently afforded by Note 2 on Rule 13. However, the Code Committee believes that, in striking the appropriate balance between, on the one hand, the legitimate interests of the offeror in seeking protection and, on the other, the undesirability of an offer failing contrary to the reasonable expectations of offeree company shareholders and the market as a whole, it is

legitimate for the Code to impose a high supervening threshold for the invocation of conditions in all cases and that an offeror should not be able to “contract out” of Note 2.

4.11 The Code Committee therefore believes that Note 2 should apply in all cases, including in relation to bespoke and negotiated conditions. However, in considering whether a particular matter should give rise to the right to invoke a condition, the Code Committee is of the view that the Panel should take into account all relevant factors, including:

- whether the condition was the subject of negotiation with the offeree company;
- whether the condition was expressly drawn to offeree company shareholders’ attention in the offer document or announcement, with a clear explanation of the circumstances which might give rise to the right to invoke it; and
- whether the condition was included to take account of the particular nature of the business of the offeree company.

The Code Committee is proposing that these factors should be reflected in a new Note on Rule 13.

4.12 Therefore, for example, if a recommended offer includes the following condition:

“the ‘net debt’ of the offeree company being certified as being not more than £100 million as at the date on which the offer becomes or is declared unconditional as to acceptances”,

the Code Committee believes that the Panel should be more willing to allow the offeror to lapse its offer if the offeree company’s “net debt” has risen

above £100 million at the relevant time than if the offeror had not included such a condition and sought to rely on a standard MAC condition. This would particularly be the case if the figure of £100 million was significantly above the figure anticipated by the offeree company when the offer was launched, and if the offer announcement had included prominent reference to the condition and the risk of the offer failing if “net debt” increased above this level.

4.13 It should be emphasised, however, that these factors are only some of the factors to be taken into account in assessing materiality for the purposes of the test in Note 2 on Rule 13 (and are in no way intended to be determinative or exhaustive) and the Panel will, as usual, have to take into account all of the relevant circumstances which exist at the time in deciding whether the offeror should be allowed to lapse its offer.

4.14 The second sentence of Note 1 on Rule 13 provides as follows:

*“It would also normally be acceptable in an announcement for an offer to be expressed as being conditional on statements or estimates being appropriately verified.”*

4.15 The Code Committee believes that it will no longer be necessary or appropriate to retain this sentence as the circumstances contemplated by the sentence will be considered in the light of the factors outlined in paragraph 4.11 above.

**Q1 Do you agree that the test in Note 2 on Rule 13 should apply as discussed in Section 4 above?**

**Q2 Do you agree that, in considering whether a matter should give rise to a right for the offeror to lapse its offer, the Panel should take account of the factors listed in paragraph 4.11 above?**

**Q3 Do you agree that these factors should be reflected in a new Note on Rule 13?**

**Q4 Do you believe that there are any other factors which should be reflected in Rule 13?**

**Q5 Do you agree that the last sentence of Note 1 on Rule 13 should be deleted?**

## **5. PRE-CONDITIONS AND THE CODE**

5.1 As well as the application of Note 2 on Rule 13, the Code Committee has also been considering the Code's treatment of pre-conditions. The Code has for some time permitted:

- an offeror to announce a firm intention to make an offer under Rule 2.5 of the Code subject to pre-conditions which must be satisfied (or waived) before it is committed to posting its offer document; and
- a potential offeror to announce that it is considering making an offer subject to the prior satisfaction (or waiver) of pre-conditions.

5.2 Both Note 1 on Rule 2.4 and Note 6 on Rule 2.5 require prior consultation with the Panel if an offeror wants to include any pre-condition in a possible offer announcement or a firm offer announcement, but otherwise the Code includes few specific references to pre-conditions or the consequences of a pre-conditional announcement. In particular, Rule 13 does not explicitly refer to pre-conditions. The Director General's Report in the Panel's 1998-1999 Annual Report set out a number of aspects of the Panel's practice at that time in relation to pre-conditions, including that:

- depending on the circumstances of the case, pre-conditions could be in subjective form, in contrast to conditions to an offer which should, under Rule 13, normally be objective;
- it must be clear whether any pre-conditions are waivable;
- it must also be clear in the case of a possible offer announcement that, even if the specified pre-conditions are satisfied or waived, an offer will not necessarily be made; and
- if an announcement specifies all the pre-conditions to the making of an offer and states that the offeror will proceed with its offer if they are all satisfied or waived, the announcement must be structured as a firm offer announcement under Rule 2.5 (rather than as a possible offer announcement).

5.3 In now reviewing further the approach that the Panel should adopt in relation to pre-conditions, the Code Committee believes it is necessary to consider separately the two different types of announcement in which pre-conditions might be found, being, on the one hand, possible offer announcements and, on the other, announcements of a firm intention to make an offer.

## **6. POSSIBLE OFFER ANNOUNCEMENTS**

6.1 In certain circumstances, a potential offeror might make an announcement that it is considering making an offer for an offeree company at a time when it does not want to be committed to making that offer. A possible offer announcement of this kind will often be made in order to comply with Rule 2.2 of the Code, which requires an announcement to be made in a number of circumstances (including, broadly, if there would appear to have been a leak of information about the possible offer), but such an announcement might also be made even though there is no actual requirement under Rule 2.2 to make an announcement at that time.

6.2 Rule 2.4(a) provides that, where an announcement is made as a result of an obligation arising under Rule 2.2, a brief statement confirming that talks are taking place, or that the offeror is considering making an offer, is all that is required by the Code. Otherwise, the Code does not make express provision as to what information can be included in an announcement relating to a possible offer, except that Note 1 on Rule 2.4 requires prior consultation with the Panel if a person intends to refer to any pre-condition to the making of an offer in a possible offer announcement (whether made as a result of Rule 2.2 or otherwise). The Note provides as follows:

*“1. Pre-conditions*

*The Panel must be consulted in advance if a person proposes to include in an announcement any pre-condition to the making of an offer.”*

6.3 The Code also does not impose any obligation on a potential offeror making a possible offer announcement to proceed with an offer. Until a firm intention to make an offer is notified, a potential offeror may withdraw its interest in proceeding with an offer for the offeree company at any time after a possible offer announcement is made. A possible offer announcement, therefore, informs shareholders and the market of the possibility that an offer might be made for the offeree company, but provides no certainty as to whether, or when, such an offer will in fact materialise or, subject to Rule 2.4(c), as to the terms on which any offer might be forthcoming.

6.4 In considering whether pre-conditions in a possible offer announcement should be allowed, the Code Committee is of the opinion that, given the inherent uncertainty that such an announcement creates, from shareholders' and the market's perspective the inclusion of more information about the offer and the potential offeror's intentions must (provided the information is clear and accurate) be presumed to be preferable to less information. This applies not only to information about the terms on which the offer might be made (such as the price which is being considered by the potential offeror), but also



to any pre-conditions that must be satisfied or waived before the offeror will commit to making the offer. If a potential offeror includes details of any pre-conditions to its offer in a possible offer announcement, shareholders and the market will be better able to assess its intentions and the circumstances in which an offer might be forthcoming.

- 6.5 The Code Committee is therefore of the view that the inclusion of pre-conditions to the making of an offer in a possible offer announcement is reasonable. This will be the case even when the pre-conditions are in subjective form rather than being objective because, since the offeror is not committed to proceed with the offer even if the pre-conditions are satisfied, the making of the offer is in practice within the discretion of the potential offeror and there is, therefore, no real benefit to be gained in terms of certainty from requiring any stated pre-conditions to be framed only in objective terms. A possible offer can therefore be pre-conditional on, for example, offeree company board recommendation, satisfactory due diligence or arranging the necessary financing to mount a full bid.
- 6.6 There might be scope, however, for pre-conditions in a possible offer announcement to create a misleading or confusing impression: for example, shareholders and the market might reasonably conclude that no offer will be made if a particular pre-condition becomes incapable of satisfaction, unless the potential offeror has also reserved the right to waive the pre-condition. The Code Committee therefore believes that, in order to avoid false market concerns, it must be clear from the wording of any possible offer announcement referring to pre-conditions whether or not the pre-conditions must be satisfied before an offer can be made, or whether they are waivable. If a pre-condition is not stated to be waivable, as a result of Rule 2.4(c) the offeror would not normally then be permitted to make an offer for the offeree company unless the pre-condition was clearly satisfied.
- 6.7 In order to ensure that there is no confusion as to whether the potential offeror is committed to proceed if the pre-conditions are satisfied, the Code Committee also believes that a pre-conditional possible offer announcement

should include a prominent statement that the announcement does not amount to a firm intention to make an offer and that, accordingly, there can be no certainty that any offer will be made.

**Q6 Do you agree that the inclusion of pre-conditions in a possible offer announcement is acceptable?**

**Q7 Do you agree that such pre-conditions can be in subjective form?**

**Q8 Do you agree that a pre-conditional possible offer announcement must make clear (i) whether any pre-conditions are waivable and (ii) that there can be no certainty that any offer will be made?**

## **7. ANNOUNCEMENTS OF A FIRM INTENTION TO MAKE AN OFFER**

### **(a) *Introduction***

7.1 Unlike possible offer announcements, the announcement of a firm intention to make an offer under Rule 2.5 is intended and required to provide a high level of certainty, as described above. An announcement under Rule 2.5 also starts a standard Code offer timetable, comprising up to 28 days in which to post the formal offer document to offeree company shareholders (Rule 30.1), a further 60 days within which the offer must become or be declared unconditional as to acceptances (Rule 31.6) and a further 21 days within which all other conditions to the offer must be either satisfied or waived (Rule 31.7).

7.2 Against this background, the inclusion of pre-conditions can have a significant effect on the situation that would normally exist following the release of a firm offer announcement under Rule 2.5, because:

- the standard Code timetable will not start until the pre-conditions have been satisfied or waived;

- according to the 1998-1999 Annual Report, pre-conditions can in certain circumstances be subjective; and
- it is not clear from the Code to what extent the principles which underlie Note 2 on Rule 13 apply to pre-conditions – i.e. whether there is any overriding materiality threshold that must be exceeded in order for a pre-condition to be capable of being invoked causing the offer not to proceed.

7.3 There is, therefore, clear tension between the normal standard of certainty that applies when a Rule 2.5 announcement is made and the level of uncertainty that can result from the imposition of pre-conditions which might be wide and/or subjective in form. Given this tension, the Code Committee has been considering three questions in this context: whether pre-conditions should be allowed at all in firm offer announcements; if pre-conditions are allowed in principle, when the Panel should permit a Rule 2.5 announcement to be made on a pre-conditional basis; and what restrictions should be placed on an offeror's ability to invoke any pre-conditions so permitted.

**(b) *Acceptability of pre-conditions in principle***

7.4 In relation to the first of these questions, the Code Committee is of the view that there is no fundamental objection, as a matter of principle, to an offeror using a pre-conditional offer structure when it announces a firm intention to make an offer. Indeed, the Code Committee believes there will be situations in which a pre-conditional Rule 2.5 structure will in fact be preferable to a conventional offer.

7.5 For example, under a conventional offer structure, if the offer lapses under Rule 12 as a result of a reference to the Competition Commission, the offeror will be permitted by the Notes on Rule 35.1 to make a further offer for the offeree company if the transaction is subsequently cleared by the Competition Commission and the offeror announces its new offer within 21 days of clearance being given. However, in these circumstances, there is no obligation

on the offeror to make a further offer and, if it does, no restriction on the offeror making its second offer at a price lower than its original offer. Structuring the offer on a pre-conditional basis, on the other hand, with a commitment by the offeror to proceed at the offer price if the relevant pre-condition relating to competition clearance is satisfied, will provide greater certainty for shareholders and the market than the alternative of lapsing and re-offering.

7.6 Accordingly, the Code Committee does not believe that the Code should seek to prohibit pre-conditional firm offer announcements.

**Q9 Do you agree that the Code should not prohibit pre-conditional firm offer announcements as a matter of principle?**

(c) *Allowable pre-conditions*

7.7 Assuming that pre-conditions are acceptable in Rule 2.5 announcements in principle, the Code Committee has also been considering whether the standard for including a pre-condition should be the same as that for a condition under Rule 13 or whether the Code should allow wide and/or subjective pre-conditions.

7.8 The principal arguments in favour of allowing greater flexibility in relation to the inclusion of pre-conditions are as follows:

- not allowing wide and/or subjective pre-conditions in firm offer announcements could be expected to lead to more possible offer announcements where the offeror would have greater flexibility in casting the pre-conditions to launching its offer. This would be to the disadvantage of shareholders and the market who would be deprived of the commitment in a pre-conditional firm offer announcement that the offeror will proceed to make an offer on the stated terms if the pre-conditions are satisfied. To insist that a firm offer announcement cannot include wide

and/or subjective pre-conditions would, therefore, discourage desirable announcements and do no more than encourage offerors to structure their announcements as possible offer announcements instead;

- similarly, and particularly if there are significant competition or regulatory issues involved such that a conventional offer would in all likelihood lapse under Rule 12 or because of failure to obtain relevant approvals within the usual Code timetable, an offeror might prefer to adopt the route of lapsing and re-offering rather than use a pre-conditional structure. Again, as explained above, this would be to the disadvantage of shareholders;
- provided it is clear from the terms of the announcement that the posting of the offer document is subject to the satisfaction or waiver of any pre-conditions, even if they are wide and/or subjective, shareholders and the market will not be misled as to the likelihood that the offer will proceed; and
- concerns as to the undesirability of pre-conditions should be off-set by a recognition that the announcement of a pre-conditional offer, even when the pre-conditions are wide and/or subjective, is consistent with the general philosophy that, from shareholders' and the market's perspective, more information must be presumed preferable to less information and that the early announcement of information relating to offers is to be encouraged so as to keep shareholders and the market properly informed.

7.9 The principal arguments in favour of applying to the inclusion of pre-conditions the same standards as those which apply in relation to conventional offer conditions are as follows:

- the existence of wide and/or subjective pre-conditions might mean that, in practice, the offeror is no more committed to proceed with the offer than if it had simply made a possible offer announcement. Allowing such pre-conditions is, accordingly, inconsistent with General Principle 3;

- an offeror would be able to gain a significant advantage by adopting a pre-conditional offer structure rather than a conventional offer structure since it would be able to “test the water” by purporting to make an offer, but without the usual commitment to proceed that would be expected when a firm offer is announced;
- it is unrealistic to expect that shareholders and the market will be able adequately to assess the likelihood of wide and/or subjective pre-conditions being satisfied or will be in a position to analyse the detail of many pages of detailed drafting in order to assess the circumstances in which the offer might fail. Shareholders and the market should be entitled to expect that an offer announcement is either a firm offer announcement according to the usually understood, supervening Code standard, or relates to a possible offer in which case they will be able to apply an appropriate discount; and
- to the extent that the early announcement of information relating to offers is to be encouraged, this should not be considered as an overriding principle and, in any event, this principle will still be satisfied if the offeror simply makes a possible offer announcement instead (which can include wide and/or subjective pre-conditions).

7.10 Having considered these issues, the Code Committee recognises that, if an offeror is not allowed to include wide and/or subjective pre-conditions in a firm offer announcement, it might simply structure its announcement as a possible offer announcement instead and it might be argued that little will then have been achieved, other than depriving shareholders and the market of the commitment on the part of the offeror that would be demonstrated were it permitted to make a pre-conditional Rule 2.5 announcement.

7.11 However, the Code Committee does not believe that allowing wide and/or subjective protective pre-conditions would be consistent with the certainty

required of firm offer announcements by General Principle 3 and, taken to its logical conclusion, might be expected to lead to offerors routinely announcing firm offers subject to, for example, due diligence, with the result that the certainty afforded by General Principle 3 would only apply once an offer document was posted, rather than when a firm intention to make an offer was announced. The Code Committee therefore believes that the standard for including pre-conditions in a Rule 2.5 announcement should be the same as the standard which is applied by Rule 13 to offer conditions.

**Q10 Do you agree that the standard for including pre-conditions in a Rule 2.5 announcement should be the same as the standard which is applied by Rule 13 to conventional offer conditions?**

7.12 Further, given that the usual Code timetable will not start until any pre-conditions have been satisfied or waived and given the issues outlined above, the Code Committee is of the view that the circumstances in which pre-conditions should be permitted at all should be limited. Otherwise an offeror might subject an offeree company to “siege” for an extended period of time without the usual Code timetable running.

7.13 However, there are situations where a pre-conditional offer structure is preferable to a conventional, conditional offer structure. As mentioned above, where a conventional offer would lapse because of a reference to the Competition Commission or the initiation of proceedings by the European Commission, adopting a pre-conditional structure (i.e. with a pre-condition relating to obtaining the relevant competition clearance) will provide greater certainty for the parties, shareholders and the market because the offeror will be committed to proceed on the terms announced if clearance is obtained. In these cases, there should also be less concern about there being an extended period of siege because even under a conventional offer structure the offeror would normally be permitted by Note (a)(iii) on Rule 35.1 to re-bid once cleared, even though its offer had previously lapsed.

7.14 Similarly, if a conventional offer fails because another regulatory clearance cannot be obtained within the usual Code timetable, the offeror will normally be allowed to make a further offer, once the clearance is subsequently received, either with the recommendation of the offeree company board or if the provisions of Note (b) on Rule 35.1 apply. Note (b) provides as follows:

*“(b) The Panel may also grant consent in circumstances in which it is likely to prove, or has proved, impossible to obtain material regulatory clearances relating to the offer within the Code timetable. ... ”*

In either case, again, there is no certainty that the second offer will be made and the offeror will not be bound by its original offer price. If the offer had been made pre-conditional on receiving the regulatory clearance, however, the offeror would be obliged to proceed on the terms announced if the pre-condition was satisfied (or waived).

7.15 The Code Committee is, therefore, of the view that an offeror should normally be permitted to announce a firm offer subject to a pre-condition only if the pre-condition concerned:

- relates to OFT/Competition Commission or European Commission clearance; or
- involves another material official authorisation or regulatory clearance relating to the offer and either the offer is recommended by the board of the offeree company or the Panel is satisfied that it is likely to prove impossible to obtain the authorisation or clearance within the usual Code timetable.

**Q11 Do you agree with the above conclusions as to when a firm offer can be announced on a pre-conditional basis?**



7.16 In circumstances where it becomes clear after announcement of a firm offer, but before posting the offer document, that one or more offer conditions (as distinct from pre-conditions) is breached (and not capable of remedy) or otherwise incapable of satisfaction in accordance with the usual standards applicable under Rule 13, it is the Panel's practice to grant a dispensation from the otherwise pointless obligation under Rules 2.7 and 30.1 to post the offer document. The Code Committee is proposing that Rule 2.7 be amended to reflect this practice.

**Q12 Do you agree that Rule 2.7 should be amended to reflect the Panel's practice described in paragraph 7.16 above?**

7.17 In circumstances where an offeror is permitted to announce a pre-conditional offer, the offer conditions are effectively imported into the pre-conditional period. In such circumstances, and in the light of the conclusion set out in paragraph 7.20 below, the Code Committee does not believe that it is necessary for the offeror also to include the conditions to its offer as pre-conditions alongside any pre-conditions permitted on the basis set out above. Furthermore, the Code Committee believes that repeating the offer conditions as pre-conditions might confuse shareholders and the market.

**Q13 Do you agree that it is not necessary to repeat offer conditions as pre-conditions in a pre-conditional offer announcement?**

**(d) *Invocation of pre-conditions***

7.18 The Code Committee has also been considering whether the standard for invoking pre-conditions should be the same as that for a condition under Rule 13 or whether the Code should allow the invocation of pre-conditions without reference to a supervening materiality test.

7.19 Given the above arguments for applying the standards of Rule 13 to the inclusion of pre-conditions, the Code Committee is concerned that allowing greater flexibility in relation to the invocation of pre-conditions to posting an

offer than is normally permitted in relation to the conditions to which an offer is subject would lead to a serious erosion of the Code's overriding objective to provide an orderly framework within which takeovers are conducted. In the view of the Code Committee, the Code currently establishes a number of principles in the area of offer conditions which are important, as follows:

- because of the effect that a firm offer announcement can be expected to have upon the offeree company and the market, the Code should seek to protect against the undesirability of an offer failing contrary to the reasonable expectations of shareholders and the market, and the bar for the invocation of conditions should legitimately be a high one;
- as established by General Principle 3, a firm offer should only be announced when the offeror has every reason to believe that it can and will continue to be able to implement its offer. As a result, on announcement of a firm offer, an offeror should have every expectation that any conditions or pre-conditions to its offer will be duly satisfied (or waived);
- given the undesirability of offers failing due to the invocation of protective conditions other than for material events, it is unsatisfactory for the determination of satisfaction or otherwise of conditions to rest solely with the offeror;
- it is important that the relevant standard for the invocation of a condition causing an offer to lapse should be predictable and readily understood by shareholders, the market and, indeed, the parties to an offer and their advisers. It should not be necessary to analyse the detail of many pages of careful drafting in order properly to understand the circumstances in which a particular offer might fail. The Code should therefore apply a regime that will often override the detailed drafting of conditions and is standardised across all offers; and

- given General Principle 3 and that a firm offer announcement should provide a high level of certainty and a basis for the establishment of expectations according to a uniform and readily understood standard, there should be clear delineation between a firm offer announcement and a possible offer announcement where the offeror is not committed to proceed with its interest in the offeree company.

7.20 The Code Committee does not believe that allowing the invocation of pre-conditions other than for material events, would be consistent with these principles. The Code Committee therefore believes that the test set out in Note 2 on Rule 13 should apply to pre-conditions in the same way as it applies to conditions (including that Note 2 on Rule 13 should not apply to a UK or EC competition pre-condition).

**Q14 Do you agree that the test set out in Note 2 on Rule 13 should apply to the invocation of pre-conditions included in a Rule 2.5 announcement as it applies to conventional offer conditions?**

*(e) Financing pre-conditions*

7.21 As mentioned above, under General Principle 3 a firm offer announcement should only be made when the offeror has every reason to believe that it can and will continue to be able to implement the offer. Accordingly, it is not acceptable for an offeror to announce, or post, a firm offer which includes a condition relating to arranging necessary financing. This applies both in relation to the financing required to settle the consideration due under a cash offer and also to any working capital required for the offeror or the enlarged group post-acquisition. An offeror will usually, therefore, be required to secure any necessary external borrowings before announcing its offer.

7.22 In the light of its conclusions above, the Code Committee believes the prohibition on financing conditions should normally apply also in relation to pre-conditions. However, the Code Committee also recognises that, in

exceptional cases, where the expected timetable for satisfying any permitted pre-condition is unusually lengthy, it might not be reasonable (because of the cost of doing so) to expect the offeror to maintain committed external financing throughout the whole offer period. For example, the Code Committee is aware of transactions where the expected timetable for receipt of material regulatory clearances has been close to, or even longer than, a year following announcement of the transaction.

7.23 Where an offer is already permitted to be made on a pre-conditional basis as set out in section (c) above, the Code Committee believes that in the circumstances described in the previous paragraph it ought also to be permissible to include a financing pre-condition, provided that:

- the financing pre-condition is satisfied (or waived), or the offer is withdrawn, within 21 days after the satisfaction (or waiver) of the other permitted pre-condition(s); and
- the offeror and its financial adviser confirm in writing to the Panel before announcement of the offer that they are not aware of any reason why the offeror would be unable to satisfy the financing pre-condition within that 21 day period.

7.24 It should be emphasised, however, that a financing pre-condition of this nature would only be permitted in exceptional circumstances where the regulatory timetable is likely to be unusually lengthy. The Code Committee does not consider that the timetable for obtaining any necessary OFT/Competition Commission and/or European Commission clearances would typically satisfy this requirement.

**Q15 Do you agree with the Code Committee's conclusions in relation to financing pre-conditions?**

## **8. OBLIGATION TO SATISFY PRE-CONDITIONS IN FIRM OFFER ANNOUNCEMENTS AND OFFER CONDITIONS**

- 8.1 As mentioned above, while Note 2 on Rule 13 expressly states that the invocation of the acceptance condition and of UK and EC competition conditions is not subject to the “material significance” test, Note 2 also does not apply in practice to other conditions required to give effect to some overriding statutory or regulatory requirement necessary to implement the offer or to issue any consideration securities under the terms of the offer, such as a listing condition or a Class 1 shareholder approval condition (or a similar condition in another jurisdiction).
- 8.2 In certain circumstances, such as if there has been a deterioration in the offeree company’s trading following announcement of the offer, an offeror may decide that it wishes to lapse its offer but be unable to invoke a protective condition because there is no relevant condition covering the circumstances that have arisen or, if there is, because the test in Note 2 on Rule 13 has not been satisfied. There is a risk in such circumstances that the offeror may seek to cause a statutory/regulatory condition (to which Note 2 on Rule 13 would not apply) not to be satisfied and then to invoke that condition in order to cause its offer to lapse, which it would not otherwise be able to do.
- 8.3 The Code Committee believes that, following a firm offer announcement, General Principle 3 implies an obligation on an offeror to use all reasonable efforts to satisfy the conditions and pre-conditions to its offer and that, for example, the use by an offeror of a statutory/regulatory condition as a device to cause its offer to lapse in the manner described above would be a breach of this obligation and the spirit of the Code. For example, the Code Committee would expect the board of directors of an offeror actively to pursue, in a timely manner, any application made to competition or other regulatory authorities or a listing application to the UKLA.
- 8.4 In relation to shareholder approvals, the duty of potential offerors and their advisers under General Principle 3 was considered by the Panel in relation to

the proposed offer by Wm Low and Co PLC for Budgens plc, as reported in Panel Statement 1989/14. The Statement included the following paragraph in this regard:

“... [T]he Panel is conscious that at all times directors who are inviting their shareholders to vote on the issue of whether or not to support an offer must give their advice in the light of their continuing fiduciary duty to the company. This means that, in the event of a fundamental change of circumstances, it may be necessary for them to change the view which they conscientiously held at the time of the announcement of the offer. In its 1974 annual report, the Panel made clear that where resolutions from offeror shareholders are necessary, the Panel does not take the view that the directors of the offeror are obliged to recommend shareholders to vote in favour of the offer in all circumstances. But it was stressed that directors are not free to ignore what they have done in the name of the company. Since failure to proceed is a very serious matter, the directors must bear this in mind in making their recommendation. It equally follows that, in order to do all they can to avoid a situation arising where they may ultimately recommend their shareholders to vote against an offer which they have announced, the company and its advisers have to meet a high standard in fulfilling the obligation to exercise care.”

8.5 The Code Committee believes that the principles referred to by the Panel in the above paragraph remain valid.

8.6 The Code Committee believes that the obligation on an offeror to use all reasonable efforts to ensure the timely satisfaction of the conditions and pre-conditions to its offer, as implied by General Principle 3, should be reflected in the Code.

**Q16 Do you agree with the Code Committee’s conclusions in relation to the obligation to satisfy offer conditions and pre-conditions?**

## 9. OFFEREE PROTECTION CONDITIONS

### (a) *Introduction*

9.1 On 21 July 2003, the Code Committee published PCP15 on offeree protection conditions. The PCP proposed introducing a reciprocal test for the invocation of offeree protection conditions to that which applies to the invocation of conditions included for the benefit of the offeror. Accordingly, the PCP proposed that Note 2 of Rule 13 should be amended as follows:

*“An offeror or an offeree company should not invoke any condition so as to cause the offer to lapse unless the circumstances which give rise to the right to invoke the condition are of material significance to it in the context of the offer. The acceptance condition, and any condition included pursuant to Rule 12.1(c), are not subject to this provision.”*

9.2 On 28 November 2003, the Code Committee announced that the consultation exercise in relation to the proposed amendments had raised a number of important issues which the Code Committee was considering and that the Code Committee would make a further announcement in due course.

### (b) *Issues arising out of the consultation exercise*

9.3 As part of the consultation exercise, the following points were raised with the Code Committee about the proposal in PCP15 to introduce a reciprocal test for the invocation of offeree protection conditions to that which applies to the invocation of conditions included for the benefit of the offeror:

(a) the effect of the proposal was to provide protection for the offeror company and its shareholders to the detriment of the offeree company and its shareholders. This ran contrary to the Code’s general ethos of seeking to protect shareholders in the offeree company, particularly given that the offeror will specifically have agreed to the terms of the offeree protection conditions. In addition, it was contrary to the

Panel's customary practice not only not to hold an offeror to a statement which it has made (i.e. that its offer is subject to the terms of the offeree protection conditions), but also to assist the offeror in not being bound by it;

- (b) there was a significant difference between, on the one hand, permitting an offeror to walk away from an announced offer only in limited circumstances and, on the other hand, obliging shareholders in the offeree company to receive securities in the offeror company which may have declined in value since the announcement of the offer. Furthermore, whilst it may be understandable for the Code to override contractual provisions in so far as they relate to conditions included for the benefit of the offeror, this was less justifiable where the conditions were included for the benefit of the shareholders in the offeree company;
- (c) it was stated in PCP15 that offeree protection conditions are usually a feature of transactions where the offeror and the offeree company are of similar size such that the identity of the offeror and offeree company could easily be reversed. As a result, it was stated in PCP15 that it was logical and sensible for the test for whether an offeree protection condition could be invoked to be the same as the test for whether an offeror can invoke a condition for its benefit. Two points were raised in this regard:
  - (i) although not currently commonplace, offeree protection conditions may become a feature of recommended transactions where the offeror and the offeree company are not necessarily of similar size. In such cases, it is arguable that a lower threshold for the invocation of offeree protection conditions should be applied from that which might be appropriate in the context of a merger of equals; and



- (ii) in the context of a conventional offer, it is not possible to achieve absolute symmetry between an offeror on the one hand and shareholders in the offeree company on the other. This is because the two parties to the contract, being the offeror and the shareholders in the offeree company, have different rights by virtue of who they are. In particular, an offeror has the right to lapse its offer if its acceptance condition is not met without reference to a materiality threshold. By contrast, where withdrawal rights are not running, offeree protection conditions are the only means that offeree company shareholders who have accepted have of protecting themselves in the event of there being a development relating to the offeror which may materially and adversely affect the value of the consideration securities they are to receive. As a result, there could be cases where the operation of Note 2 on Rule 13 as proposed to be amended in PCP15 would materially prejudice shareholders in the offeree company. Accordingly, it was argued that the threshold for invoking offeree protection conditions should be lower than the threshold for invoking conditions for the benefit of the offeror.

(c) *The Code Committee's conclusions*

9.4 The Code Committee acknowledges the force of these arguments and has concluded that Note 2 on Rule 13 should not be amended on the basis set out in PCP15. However, the Code Committee continues to believe, in line with its conclusions on the circumstances in which conditions and pre-conditions for the benefit of an offeror may be invoked as set out above, that it is appropriate for the Panel to be the arbiter of whether an offeree protection condition can be invoked. In addition, the Code Committee considers the following points to be relevant to the invocation of offeree protection conditions:

- (a) the Panel should have the flexibility to consider each case on its merits, taking into account all relevant facts, including: the circumstances

which potentially give rise to the right to invoke the offeree protection condition; the size of the offeree company relative to the offeror; the wording of the offeree protection condition; the recommendation of the board of the offeree company and the views of its advisers; and the views of the offeror and its advisers;

- (b) for the reasons explained in paragraph 9.3(c)(ii) above, the threshold for invoking an offeree protection condition should not necessarily be the same as that for invoking a condition for the benefit of the offeror;
- (c) when considering whether an offeree protection condition can be invoked, the Panel should not necessarily be faced only with the binary decision as to whether the offer should proceed or lapse. Instead, the Panel should have the flexibility to require the introduction of withdrawal rights in such circumstances, thereby allowing shareholders in the offeree company to make the decision as to whether the offer should lapse as a result of the circumstances in question.

9.5 Although, as explained in paragraph 9.6(b) below, the Code Committee believes that the precise mechanics relating to the operation of withdrawal rights in these circumstances would need to be determined by the Panel on a case by case basis, the Code Committee envisages that the broad outline would be as follows:

- (a) where the events in question occur prior to the offer becoming or being declared, or being capable of being declared, unconditional as to acceptances: withdrawal rights would be introduced, possibly earlier than would normally be the case under Rule 34, and would be available for a fixed period stipulated by the Panel during which time the offeror would not be permitted to declare the offer unconditional as to acceptances. At the end of the period stipulated by the Panel, the offeror would be permitted, but not required, to declare the offer unconditional as to acceptances if at that time it had received sufficient acceptances to satisfy its acceptance condition;

- (b) where the events in question occur after the offer has become or been declared unconditional as to acceptances (by which time, under Rule 34, withdrawal rights will normally have ceased to run): the offeror would be required to declare that the offer is no longer unconditional as to acceptances and would be required to (re)introduce withdrawal rights for a fixed period stipulated by the Panel during which time the offeror would not be permitted to declare the offer unconditional as to acceptances. At the end of the period stipulated by the Panel, the offeror would be permitted, but not required, to declare the offer unconditional as to acceptances if at that time it had received sufficient acceptances to satisfy its acceptance condition (and regardless of whether its acceptance level was by then lower than it was at the time that the withdrawal rights were (re)introduced); and
  
- (c) where the events in question occur at a time when the offer is capable of being declared unconditional as to acceptances, but prior to it actually having been declared unconditional as to acceptances: as for (b), save that there will be no requirement at the outset for the offeror to declare that the offer is no longer unconditional as to acceptances.

Clearly, once the offer has become or been declared wholly unconditional, the ability for an offeree company to invoke, or to cause or permit the offeror to invoke, an offeree protection condition will cease.

9.6 With regard to the operation of withdrawal rights in such circumstances, the Code Committee is of the view that:

- (a) the ability of the Panel to determine that withdrawal rights be introduced in such circumstances, and also the fact that, if appropriate, the offer will then cease to be unconditional as to acceptances, should be incorporated into the terms of the offer;

- (b) save as set out in (c) below, it is not necessary or appropriate for the precise mechanics relating to the introduction and operation of the withdrawal rights (such as the period for which they should be available) and any consequential timetable issues to be set out in the Code (including, for example, if the offer is at the time unconditional as to acceptances, what the revised Day 60 should be under Rule 31.6). Instead, these should be matters to be determined by the Panel at the relevant time taking account of the facts of the case and the views of all relevant parties. However, the Code Committee expects that, if appropriate, an offer period would re-commence in respect of the offeree company at the same time as the withdrawal rights were introduced and that the normal provisions of the Code would then apply – for example, dealings in relevant securities would be required to be disclosed under Rule 8 and the board of the offeree company would be subject to the restrictions contained in Rule 21.1; and
  
- (c) a Note should be included on Rule 38.3 to provide that if withdrawal rights are introduced (i) after the offer is unconditional as to acceptances, and (ii) after an exempt market-maker connected with the offeror has accepted any offeree company shares to the offer as permitted by Rule 38.3, any offeree company shares so accepted to the offer by an exempt market-maker connected with the offeror should be required to be withdrawn and should not be capable of being re-accepted to the offer unless, following the period agreed by the Panel for withdrawal rights to run, the offer becomes or is declared unconditional as to acceptances.

9.7 The Code Committee has considered whether there should be a provision in the Code to prohibit an offeror from declaring its offer wholly unconditional if it has been notified by the board of the offeree company that it wishes to invoke an offeree protection condition. The purpose of such a provision would be in order to ensure that the offeror is not able to deny the Panel the opportunity to decide whether an offeree protection condition can legitimately be invoked. However, the Code Committee does not believe that this is

necessary on the basis that an offeree protection condition can only be waived by the offeror at the direction of or with the consent of the offeree company.

**Q17 Do you agree with the Code Committee's conclusions in relation to offeree protection conditions?**

## **10. CODE AMENDMENTS**

### **(a) *Amendments to reflect the above proposals***

10.1 The amendments to the Code necessary to reflect the Code Committee's proposals set out above in this Consultation Paper are set out in Appendix A. These include:

- amending Note 1 on Rule 2.4 to require that any announcement of a possible offer subject to pre-conditions states whether the pre-conditions are waivable and that there can be no certainty that an offer will be made (see paragraphs 6.6 and 6.7 above);
- including a new provision in Rule 13 setting out the circumstances in which an offeror will normally be permitted to make a firm offer subject to one or more pre-conditions (see paragraph 7.15 above);
- including a new Note in relation to the acceptability of financing pre-conditions in exceptional cases (paragraph 7.23 above);
- amending what is currently Note 2 on Rule 13, including setting out some of the factors that the Panel will take into account in determining whether a condition or pre-condition to an offer might be invoked (see paragraph 4.11 above);

- deleting the last sentence of what is currently Note 1 on Rule 13 because the circumstances contemplated there will be considered in the light of the factors outlined in the preceding paragraph (see paragraph 4.15 above);
- including a new provision in Rule 13 requiring an offeror to use all reasonable efforts to ensure the satisfaction of conditions and pre-conditions to the offer (see paragraph 8.6 above);
- amending Rule 13 generally to apply to pre-conditions as well as to conventional offer conditions (see paragraph 7.11 and 7.20 above); and
- including new provisions in Rule 13 in relation to offeree protection conditions and including amendments to Rules 34 and 38.3 to take account of the availability of withdrawal rights in certain circumstances (see paragraphs 9.4 to 9.6 above).

10.2 At the same time, the Code Committee proposes to restructure Rule 13 to make its application clearer. The Code Committee also proposes to amend Note 3(b) on Rule 9.3 and Notes (b) and (c) on Rules 35.1 and 35.2 so that they refer to “official authorisations” as well as to “regulatory clearances” and are therefore consistent with Rule 13 (as proposed to be amended).

10.3 Assuming these proposed changes are adopted, the Code Committee does not consider that the guidance contained in the Panel’s 1998-1999 Annual Report will have any continuing application.

**(b) *Amendments to Rule 2.7***

10.4 As mentioned in paragraph 3.5 above, under Rule 2.7, following the making of a firm offer announcement under Rule 2.5, the offeror is normally required to proceed with posting the offer document and cannot withdraw unilaterally. Rule 2.7 provides as follows:

**“When there has been an announcement of a firm intention to make an offer, the offeror must, except with the consent of the Panel, proceed with the offer unless the posting of the offer is subject to the prior fulfilment of a specific condition and that condition has not been met.”**

Note 1 on Rule 2.7 then goes on as follows:

*“1. Failure to proceed – exceptional circumstances*

*A change in general economic, industrial or political circumstances will not justify failure to proceed with an announced offer: to justify a decision not to proceed, circumstances of an exceptional and specific nature are required.”*

- 10.5 Note 1 on Rule 2.7 dates from before the time that the current Note 2 on Rule 13 was introduced into the Code, when it was not customary for an offeror to specify all of the conditions to which its offer was subject. The purpose of the Note was to make clear that changes in general economic, industrial or political circumstances were hazards that an offeror had to accept in a takeover situation and would not normally be sufficient to justify unilateral withdrawal by the offeror.
- 10.6 The Code Committee believes that the rationale behind Note 1 on Rule 2.7 has now been superseded by changes in the Code since it was first introduced, and in particular by Note 2 on Rule 13. Indeed, the Panel explained in Statement 2001/15 that it considered a change in general economic circumstances might legitimately be relied upon when seeking to invoke a condition to an offer, but only if the requirements of materiality in Note 2 on Rule 13 were met. The Code Committee agrees with this interpretation of Note 1 on Rule 2.7 and is, therefore, proposing that the Note be deleted from the Code.
- 10.7 At the same time, the Code Committee believes that, in the light of the other Code amendments proposed in this Consultation Paper, the reference in Rule 2.7 to an offeror being obliged to proceed with its offer “unless the posting of the offer is subject to the prior fulfilment of a specific condition and that

condition has not been met” might be misleading. If the other proposals in this Consultation Paper are adopted, an offeror which announces a firm offer subject to a pre-condition will only be permitted not to proceed with its offer if it is able to invoke that pre-condition in accordance with the provisions of the amended Rule 13 or if it would be able to invoke a condition if the offer were made (see paragraph 7.16 above).

- 10.8 The Code Committee is proposing that Rule 2.7 be amended (as set out in Appendix A) to reflect these points.

(c) ***Amendments to Note 2 on Rule 23***

- 10.9 Note 2 on Rule 23 provides as follows:

“2. *Pre-conditional offers*

*When an offer has been announced, the making of which is subject to a pre-condition relating to action by offeree company shareholders (eg the rejection of a proposed acquisition or disposal), the first major circular sent by the potential offeror to those shareholders must normally include the information which would be required by Rule 24 to be included in that circular if it were an offer document.”*

- 10.10 If the changes to the circumstances in which pre-conditional offers may be made are adopted as proposed in this Consultation Paper, Note 2 on Rule 23 will, as written, no longer be relevant since it will not normally be permissible to announce an offer subject to a pre-condition relating to action by offeree company shareholders. This is because a pre-condition of this nature would not satisfy either of the criteria set out in paragraph 7.15 above. It would, however, be acceptable for a condition to be included in an offer announcement to this effect.

- 10.11 The Code Committee understands that it is the Panel’s practice also to apply Note 2 on Rule 23 to an offer that is subject to a condition (rather than a pre-



condition) relating to offeree company shareholder action. For example, if an offeror announced a firm intention to make an offer conditional on offeree company shareholders voting against a resolution to approve a proposed acquisition or disposal and then wished to post a copy of the announcement to offeree company shareholders, the Panel would require the offeror also to provide offeree company shareholders with the information specified in Note 2 on Rule 23.

10.12 The Code Committee believes that where an offeror is seeking, prior to the posting of its offer document, to persuade offeree company shareholders to take a certain course of action, for example to vote against a resolution at a forthcoming shareholder meeting, it should provide those shareholders with sufficient information about itself and its offer (i.e. the information required by Rule 24) to enable offeree company shareholders to make an informed decision when deciding what action to take.

10.13 The Code Committee is therefore proposing that Note 2 on Rule 23 be amended (as set out in Appendix A) to reflect this point.

**(d) Amendments to Rule 24.6**

10.14 The Code Committee considers that the matters referred to in proposed Rules 13.4(a) and (where appropriate) 13.5 should be included in the terms of the offer in order that shareholders in the offeree company are informed of the circumstances in which an offer condition or an offeree protection condition may be invoked and the potential consequences of this happening. Accordingly, the Code Committee is proposing that Rule 24.6 be amended (as set out in Appendix A) to reflect this point.

**Q18 Do you agree with the proposed amendments to the Code set out in Appendix A?**

**11. COSTS/BENEFITS**

The Code Committee believes that these proposals will provide clarity on an important aspect of takeover regulation and, as such, will be of benefit to the parties to an offer and to the market generally. The Code Committee does not believe that there are any significant cost implications for companies or investors arising out of the proposed amendments in this paper.

## APPENDIX A

### Possible Code amendments to reflect the proposals in this Consultation Paper

#### 1. Rule 2.4

##### 2.4 THE ANNOUNCEMENT OF A POSSIBLE OFFER

...

###### NOTES ON RULE 2.4

###### 1. Pre-conditions

*The Panel must be consulted in advance if a person proposes to include in an announcement any pre-condition to the making of an offer. Any such pre-conditional possible offer announcement must:*

*(a) clearly state whether or not the pre-conditions must be satisfied before an offer can be made or whether they are waivable; and*

*(b) include a prominent warning to the effect that the announcement does not amount to a firm intention to make an offer and that, accordingly, there can be no certainty that any offer will be made even if the pre-conditions are satisfied or waived.*

...

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#### 2. Rule 2.5

##### 2.5 THE ANNOUNCEMENT OF A FIRM INTENTION TO MAKE AN OFFER

...

###### NOTES ON RULE 2.5

...

## 6. *Pre-conditions*

*The Panel must be consulted in advance if a person proposes to include in an announcement any pre-condition to which the posting of the offer will be subject. (See also Rule 13.)*

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## 3. **Rule 2.7**

### 2.7 CONSEQUENCES OF A “FIRM ANNOUNCEMENT”

**When there has been an announcement of a firm intention to make an offer, the offeror must, ~~except with the consent of the Panel,~~ normally proceed with the offer unless, in accordance with the provisions of Rule 13, the offeror is permitted to invoke a pre-condition to the posting of the offer or would be permitted to invoke a condition to the offer if the offer were made ~~is subject to the prior fulfilment of a specific condition and that condition has not been met.~~**

#### *NOTES ON RULE 2.7*

##### *1. ~~Failure to proceed~~ — exceptional circumstances*

*A change in general economic, industrial or political circumstances will not justify failure to proceed with an announced offer: to justify a decision not to proceed, circumstances of an exceptional and specific nature are required.*

##### *2. When there is no need to post*

*An announced offeror need not proceed with its offer if a competitor has already posted a higher offer or, with the consent of the Panel, in the circumstances set out in Note 5 on Rule 21.1.*

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## 4. **Rule 9.3**

### 9.3 CONDITIONS AND CONSENTS

...

#### *NOTES ON RULE 9.3*

...

3. *When dispensations may be granted*

*The Panel will not normally consider a request for a dispensation under this Rule other than in exceptional circumstances, such as:-*

...

*(b) when any official authorisation or regulatory clearance is required before the offer document is posted. The person who has incurred the obligation under Rule 9 must endeavour to obtain authorisation or clearance with all due diligence. If authorisation or clearance is obtained, the offer document must be posted immediately. If authorisation or clearance is not obtained, the same consequences will follow as if the merger were prohibited following a reference to the Competition Commission or the initiation of proceedings by the European Commission (see Rule 9.4).*

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5. **Rule 13**

**RULE 13. PRE-CONDITIONS IN FIRM OFFER ANNOUNCEMENTS AND OFFER CONDITIONS**

**13.1 SUBJECTIVITY**

**An offer must not normally be subject to conditions or pre-conditions which depend solely on subjective judgements by the directors of the offeror or of the offeree company (as the case may be) or the fulfilment of which is in their hands. The Panel may be prepared to accept an element of subjectivity in certain circumstances where it is not practicable to specify all the factors on which satisfaction of a particular condition or pre-condition may depend, especially in cases involving official authorisations or regulatory clearances, the granting of which may be subject to additional material obligations for the offeror or the offeree company (as the case may be).**

**13.2 THE COMPETITION COMMISSION AND THE EUROPEAN COMMISSION**

**A condition or pre-condition included pursuant to Rule 12.1(c) is not subject to the provisions of Rules 13.1 or 13.4(a).**

**13.3 ACCEPTABILITY OF PRE-CONDITIONS**

**The Panel must be consulted in advance if a person proposes to include in an announcement any pre-condition to which the posting of the offer will be subject.**

**Except with the consent of the Panel, an offer must not be announced subject to a pre-condition unless the pre-condition: —**

**(a) is included pursuant to Rule 12.1(c); or**

**(b) involves a material official authorisation or regulatory clearance relating to the offer and:**

**(i) the offer is publicly recommended by the board of the offeree company; or**

**(ii) the Panel is satisfied that it is likely to prove impossible to obtain the authorisation or clearance within the Code timetable.**

**(See Note 6 on Rule 2.5.)**

**NOTE ON RULE 13.3**

**Financing pre-conditions**

**An offer must not normally be made subject to a condition or pre-condition relating to financing. In exceptional cases, the Panel may be prepared to accept a pre-condition relating to financing in addition to another pre-condition permitted by this Rule where, due to the likely period required to obtain any necessary material official authorisation or regulatory clearance or otherwise, it is not reasonable for the offeror to maintain committed financing throughout the offer period and provided that:**

**(a) the financing pre-condition must be satisfied (or waived), or the offer must be withdrawn, within 21 days after the satisfaction (or waiver) of the other pre-condition or pre-conditions permitted by this Rule; and**

**(b) the offeror and its financial adviser must confirm in writing to the Panel before announcement of the offer that they are not aware of any reason why the offeror would be unable to satisfy the financing pre-condition within that 21 day period.**

**13.4 INVOKING CONDITIONS AND PRE-CONDITIONS**

**(a) An offeror should not invoke any condition or pre-condition so as to cause the offer not to proceed, to lapse or to be withdrawn unless the circumstances which give rise to the right to invoke the condition or pre-condition are of material significance to the offeror in the context of the offer. The acceptance condition is not subject to this provision.**

**(b) Following the announcement of a firm intention to make an offer, an offeror should use all reasonable efforts to ensure the satisfaction of any conditions or pre-conditions to which the offer is subject.**

**NOTE ON RULE 13.4**

Relevant factors

In considering whether a condition or pre-condition can be invoked, the Panel will take into account all relevant factors, including:

(a) whether the condition or pre-condition was the subject of negotiation with the offeree company;

(b) whether the condition or pre-condition was expressly drawn to offeree company shareholders' attention in the offer document or announcement, with a clear explanation of the circumstances which might give rise to the right to invoke it; and

(c) whether the condition or pre-condition was included to take account of the particular nature of the business of the offeree company.

**13.5 INVOKING OFFEREE PROTECTION CONDITIONS**

**(a) An offeree company should not invoke, or cause or permit the offeror to invoke, any condition to an offer unless the circumstances which give rise to the right to invoke the condition are of material significance to the shareholders in the offeree company in the context of the offer. However, this does not necessarily mean that the offeree company will be allowed to invoke, or cause or permit the offeror to invoke, a condition only in circumstances where the Panel would permit an offeror to invoke such a condition. In deciding whether an offeree company may invoke, or cause or permit the offeror to invoke, a condition, the Panel will take into account all relevant factors.**

**(b) If the offeree company is not permitted to invoke, or to cause or permit the offeror to invoke, a condition, the Panel may instead determine in the light of all relevant facts that accepting shareholders should have the right to withdraw their acceptances on such terms as the Panel considers appropriate and, if so, the effect of this on the Code timetable. The ability of the Panel to require the introduction of withdrawal rights in such circumstances and to amend the Code timetable, and also the fact that the offer may cease to be unconditional as to acceptances as a result of such withdrawal rights being introduced, should be incorporated into the terms of the offer.**

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**6. Rule 23****RULE 23. THE GENERAL OBLIGATION AS TO INFORMATION**

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NOTES ON RULE 23

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2. ~~Pre conditional offers~~ Offers conditional on shareholder action

~~When an offer has been announced, the making of which is subject to a pre-condition relating to which is conditional on action by offeree company shareholders (eg the rejection of a proposed acquisition or disposal), the first major circular sent by the potential offeror to those shareholders must normally include the information which would be required by Rule 24 to be included in that circular if it were an offer document.~~

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7. Rule 24.6

**24.6 INCORPORATION OF OBLIGATIONS AND RIGHTS**

The offer document must incorporate language which appropriately reflects Notes 4-7 on Rule 10 and those parts of Rules 13.4(a), 13.5 (if applicable), 17 and 31-34 which impose timing obligations ~~or restrictions on offerors~~ or confer rights or impose restrictions on offerors, offeree companies or shareholders of the offeree companies.

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8. Rule 34

**RULE 34. RIGHT OF WITHDRAWAL**

An acceptor must be entitled to withdraw his acceptance from the date which is 21 days after the first closing date of the initial offer, if the offer has not by such date become or been declared unconditional as to acceptances. This entitlement to withdraw must be exercisable until the earlier of (a) the time that the offer becomes or is declared unconditional as to acceptances and (b) the final time for lodgement of acceptances which can be taken into account in accordance with Rule 31.6. An acceptor must also be entitled to withdraw his acceptance if so determined by the Panel in accordance with Rule 13.5.

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9. Rule 35.1

**35.1 DELAY OF 12 MONTHS**

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*NOTE ON RULES 35.1 and 35.2**When dispensations may be granted**(a) ...**(b) The Panel may also grant consent in circumstances in which it is likely to prove, or has proved, impossible to obtain material official authorisations or regulatory clearances relating to an offer within the Code timetable. ...**(c) The restrictions in Rules 35.1(d) and (e) will not normally apply to the extent that the offer lapsed as a result of being referred to the Competition Commission or the European Commission initiating proceedings, or as a result of the offeror failing to obtain another material official authorisation or regulatory clearance relating to the offer within the usual Code timetable, but the offeror is continuing to seek clearance or a decision from the relevant official or regulatory authorities with a view subsequently to making a new offer with the consent of the Panel in accordance with Note (a)(iii) or Note (b) on Rule 35.1.*

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**10. Rule 38.3****38.3 ASSENTING SECURITIES**

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*NOTE ON RULE 38.3**If withdrawal rights are introduced under Rule 13.5, the acceptances in relation to any securities assented to the offer after it was unconditional as to acceptances by an exempt market-maker connected with the offeror must be withdrawn and such securities may not be re-assented to the offer unless, following the period agreed by the Panel for withdrawal rights to run, the offer becomes or is declared unconditional as to acceptances.*

**APPENDIX B****Questions for Consultation**

- Q1** Do you agree that the test in Note 2 on Rule 13 should apply as discussed in Section 4 above?
- Q2** Do you agree that, in considering whether a matter should give rise to a right for the offeror to lapse its offer, the Panel should take account of the factors listed in paragraph 4.11 above?
- Q3** Do you agree that these factors should be reflected in a new Note on Rule 13?
- Q4** Do you believe that there are any other factors which should be reflected in Rule 13?
- Q5** Do you agree that the last sentence of Note 1 on Rule 13 should be deleted?
- Q6** Do you agree that the inclusion of pre-conditions in a possible offer announcement is acceptable?
- Q7** Do you agree that such pre-conditions can be in subjective form?
- Q8** Do you agree that a pre-conditional possible offer announcement must make clear (i) whether any pre-conditions are waivable and (ii) that there can be no certainty that any offer will be made?
- Q9** Do you agree that the Code should not prohibit pre-conditional firm offer announcements as a matter of principle?

- Q10 Do you agree that the standard for including pre-conditions in a Rule 2.5 announcement should be the same as the standard which is applied by Rule 13 to conventional offer conditions?**
- Q11 Do you agree with the above conclusions as to when a firm offer can be announced on a pre-conditional basis?**
- Q12 Do you agree that Rule 2.7 should be amended to reflect the Panel's practice described in paragraph 7.16 above?**
- Q13 Do you agree that it is not necessary to repeat offer conditions as pre-conditions in a pre-conditional offer announcement?**
- Q14 Do you agree that the test set out in Note 2 on Rule 13 should apply to the invocation of pre-conditions included in a Rule 2.5 announcement as it applies to conventional offer conditions?**
- Q15 Do you agree with the Code Committee's conclusions in relation to financing pre-conditions?**
- Q16 Do you agree with the Code Committee's conclusions in relation to the obligation to satisfy offer conditions and pre-conditions?**
- Q17 Do you agree with the Code Committee's conclusions in relation to offeree protection conditions?**
- Q18 Do you agree with the proposed amendments to the Code set out in Appendix A?**