Takeover Panel consultation paper PCP2017/1

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

Below are the views of the Takeovers Joint Working Party of the City of London Law Society Company Law Sub-Committee and the Law Society of England and Wales' Standing Committee on Company Law (the **Working Party**) on the Panel Consultation Paper PCP 2017/1 (the **PCP**).

The Law Society of England and Wales is the representative body of over 120,000 solicitors in England and Wales. The Society negotiates on behalf of the profession and makes representations to regulators and Government in both the domestic and European arena. This response has been prepared on behalf of the Law Society by members of the Company Law Committee.

The City of London Law Society (**CLLS**) represents approximately 13,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi-jurisdictional legal issues. The CLLS responds to a variety of consultations on issues of importance to its members through its 17 specialist committees.

Q1 Should an offeror or potential offeror be restricted from circumventing the provisions of the Code by purchasing the offeree company's assets following the offer or possible offer lapsing or being withdrawn?

The Code has not historically sought to regulate asset purchases or other transactions that do not involve acquiring shares in a company that is subject to the Code, and in our view it is undesirable for it to do so unless it is strictly necessary (and any amendment falls within the Panel's rule-making powers in section 942 of the Companies Act 2006). As a general rule, in our view parties should be free to structure a deal in the way that they wish unless there is good reason to restrict them from doing so.

Whilst we understand the Panel's concerns in relation to asset transactions, and can see the benefit of ensuring an even playing field in a competitive context, we do not think it is necessary for the Code to regulate these types of transactions in a non-competitive situation.

Asset transactions are, by their nature, only capable of proceeding if the target board is supportive and therefore concerns about the target company being put 'under siege' (which underpins the provisions in Rules 2.8 and 35.1) are not relevant. Where the target company is publicly traded, any substantial asset sales will also typically be subject to regulation under the relevant listing rules (in particular, for Premium Listed companies, the rules on Class 1 transactions) which are well understood by shareholders and market participants, and we would

question the benefit of another layer of restrictions imposed by the Code. In a non-competitive context, there is also no other bidder who could potentially be prejudiced by the asset sale proceeding.

We can understand more the basis for applying the proposed restrictions in the context of a competitive situation for such time as the target remains in an offer period (subject to our comments in response to Q2 below regarding the materiality test to be applied) where there is an argument for maintaining a level playing field as between competing bidders.

Q2 Should the proposed new restriction in each of Rules 2.8, 12.2 and 35.1 apply in relation to the purchase of assets which are significant in relation to the offeree company (as determined in accordance with Note 5 on Rule 2.8)?

As outlined above, we do not consider it necessary for restrictions to be imposed on asset sales in a non-competitive context. However, if the Panel were to proceed with this proposal, our view is that the draft Rules do not set the materiality threshold at the correct level.

Consistent with the rationale put forward in the PCP that the proposed rule changes are to avoid the circumvention of existing rules that apply to offers (and therefore that the rule changes should only apply to transactions that could be considered analogous to an offer), we strongly believe that a more appropriate test would be the sale of all or substantially all of the company's assets with the intention of returning the proceeds of sale to shareholders and winding up the company. As noted in paragraph 4.1 of the PCP, the economic outcome of this type of transaction for shareholders in the target may be comparable with any competing offer and this is also consistent with the approach taken in other parts of the PCP.

In our view it is not necessary for the test to be set at a lower level to ensure that the provision would be effective from an anti-avoidance perspective and it would be disproportionate and inappropriate for the Code to seek to restrict other types of asset transactions where considerably less of the aggregate assets of the target company are being sold and shareholders will retain a financial interest, and shares, in the target.

Q3 Do you have any comments on the proposed amendments to Rule 2.8, Rule 12.2 and Rule 35.1?

See our response to Q14 below in relation to the drafting of Rule 2.8 and also the Annex which includes some additional drafting comments/queries.

Q4 Where shareholder approval is sought in general meeting for a proposed action under Rule 21.1, should a requirement be introduced:

(a) for the board of an offeree company to obtain competent independent advice as to whether the financial terms of the proposed action are fair and reasonable; and

Imposing an obligation on the offeree company to obtain competent independent advice on the terms of the proposed action would seem duplicative. Shareholders will already be receiving the benefit of Rule 3 advice on the financial terms of the (hostile) offer and in circumstances where the proposed action did not result in superior value to shareholders, such Rule 3 adviser would need to revisit the advice being given in connection with the underlying offer. We would also query whether it would be appropriate or possible to obtain a fair and reasonable opinion in relation to a corporate action such as a special dividend or share buy-back as opposed to a transaction involving a disposal of assets. In addition, in the circumstances, we would query whether it is in fact always necessary given that, where target is publicly traded, the relevant listing rules will already typically govern disclosure to be made and other requirements in connection with material transactions and/or shareholder circulars.

(b) for the Panel to be consulted regarding the date on which the general meeting is to be held?

We agree with the requirement to consult with the Panel regarding the date of the general meeting.

Q5 Do you have any comments on the proposed requirement for the board of an offeree company to publish a circular in the circumstances described in the proposed new Rule 21.1(f) containing the Information set out in the proposed new Note 1 on Rule 21.1?

In circumstances where a shareholder meeting is not required, we would suggest that, as an alternative, target companies are permitted (with the consent of the Panel) to publish the relevant information via a RIS rather than in the form of a circular in order to reduce the associated costs and administrative burden. An RIS announcement would still serve the purpose of ensuring that shareholders and the market were aware of the relevant information. We appreciate that the Panel would likely refuse to grant such consent in circumstances where the frustrating action is being proposed as a defence to a hostile offer as opposed to being more minor in nature.

Where the relevant information has already been included in a defence document that has been published by the target company we assume there would be no requirement for a separate, additional circular (or RIS announcement), but it would be helpful if the Panel could confirm this.

In terms of the content of any circular or RIS announcement required under Rule 21.1(f), query whether this should also be required to include specific reference to any quantified financial benefit statement (**QFBS**) made in connection with the intended disposal (in light of the amended definition of QFBS).

We assume that, if the proposals are adopted, the Panel will produce an additional checklist of the contents requirements for any such circular (or announcement).

It is not entirely clear to us whether the underlying document giving rise to the Rule 21 action needs to be displayed in all circumstances. Providing that shareholders are given full details of the proposed transaction to enable them to vote (in accordance with the paragraphs of the proposed Note 1(a) and (e)), requiring the relevant documentation to be on display may be disproportionate and/or such documentation may be commercially sensitive. In some circumstances (for instance, main market listed issuers undertaking a Class 1 acquisition) display of documentation may be required but in many circumstances caught by Rule 21 this would not be the case (for instance, 10%+ transactions and AIM listed issuers). Moreover, in circumstances where the target is proposing to acquire a material asset triggering the requirements of Rule 21 and such acquisition is being financed externally, does the Panel envisage that such financing documentation would require disclosure as being "contracts entered into in connection with the proposed action"? If that is the case, again, we consider such disclosure to be disproportionate and in the context of financing arrangements, could be particularly sensitive.

Q6 Do you have any comments on the proposed amendments to Rule 21.1?

We would suggest that the final paragraph of the Note makes it clear that it is the target company that has responsibility for publishing the circular (or announcement) on a website. It would also be helpful to cross-refer to Note 1 on Rule 26 regarding the period of time for which the circular/announcement and associated documents must be put on display (assuming that the intention is they should be on display until the end of the offer period).

Q7 Should an offeree company be permitted to pay one or more inducement fees to a counterparty to an agreement to which Rule 21.1 applies provided that the aggregate value of the fees payable does not exceed the 1% limit referred to in Note 8 on Rule 21.1?

We agree with the principle that aggregate break fees should not in aggregate exceed 1 per cent of the value of the offer. However, we would query whether it is appropriate to restrict break fees more closely than this. For example, we do not understand why a target company conducting an asset sale should not be permitted to agree a break fee that represents more than 1 per cent of the value of the asset transaction provided, of course, that it (when aggregated with any other inducement fees) does not exceed 1 per cent of the value of the offer. The limit of 1 per cent of the value of the offer is the real protection for bidders as anything below this is not considered to be material in the context of the value of the offer.

Q8 Do you have any comments on the proposed new Note 8 on Rule 21.1?

No.

Q9 Where, in competition with an offer or possible offer, an offeree company has announced its intention to sell all or substantially all of the company's assets (excluding cash and cash equivalents) and to return to shareholders all or substantially all of the company's

cash balances (including the proceeds of any asset sale), should a statement by the offeree company quantifying the cash sum expected to be paid to shareholders be treated as a quantified financial benefits statement?

Yes – we agree it is helpful to clarify the Panel's approach in this context.

Q10 Do you have any comments on the proposed new Note on the definition of "quantified financial benefits statement"?

It is unclear whether the Note is intended to refer to statements of the aggregate amount to be returned to shareholders or of the amount per share or to both/either – it would be helpful for the wording to clarify this.

Q11 Where, in competition with an offer or possible offer, an offeree company has announced an intention to sell all or substantially all of the company's assets (excluding cash and cash equivalents) and to return to shareholders all or substantially all of the company's cash balances (including the proceeds of any asset sale), should a purchaser of some or all of those assets be restricted from acquiring interests in shares in the offeree company during the offer period unless the board of the offeree company has made a statement quantifying the amount per share that is expected to be paid to shareholders and then only to the extent that the price paid does not exceed that amount?

For our thoughts on the wider proposed changes in relation to asset sales, please see our response to Q1 and Q2 above. We do not have any further specific comments on this additional proposed amendment.

Q12 Do you have any comments on the proposed new Rule 4.7?

No.

Q13 Do you have any comments on the proposed new Note 6 on Rule 21.3?

Our understanding is that where paragraph (b) of the Note applies, paragraph (a) is disapplied – it would be helpful if the drafting could make this explicit.

As a broader point in relation to Rule 21.3, some members of the committee believe there would be merit in the Panel to considering changing its approach such that a competing offeror could simply request "the same information" as has been given to another bidder. This is on the basis that the current process results in the production of lengthy and all-encompassing request lists which then need to be reviewed in detail by target companies which, for both parties, involves incurring time and expense. Given that the net result is typically that all of the same information is requested by/provided to the second bidder, some members of the committee would therefore suggest that this creates an unnecessary administrative burden on both parties.

Q14 Do you have any comments on the proposed amendment to Rule 2.8 and to the introduction of the proposed new Note 2 on Rule 2.8?

We note that, where a statement to which Rule 2.5(a)(i) or (ii) has been made, the proposed Note 2(d) on Rule 2.8 restricts any significant asset sale for a period of three months unless a reservation was included allowing the statement made under Rule 2.5(a) to be set aside with the consent of the target board. This would result in asset sales being treated more stringently than bids. To illustrate, if a bidder (i) made a statement to which Rule 2.5(a) applied and which did not include a reservation allowing it to be set aside with target board consent and (ii) then went on to make a Rule 2.8 statement which did include a reservation allowing it to be set aside with target board consent this would result in a situation where the bidder could make an offer with target board consent, albeit the terms of such offer would need to be consistent with its previous statement under Rule 2.5(a).

We would suggest that the wording "or otherwise with the consent of the Panel" is retained in Rule 2.8 to give the Panel discretion (as currently) to permit a Rule 2.8 statement to be set aside in appropriate circumstances notwithstanding a specific reservation has not been included (by analogy, the current rule gives the Panel flexibility to agree to a Rule 2.8 statement being set aside in circumstances other than those set out in current Note 2 – for example, where it has been made inadvertently).

It would also be helpful for the Panel to clarify the impact of the target announcing a formal sales process/strategic review and whether this would be permitted as a reservation a Rule 2.8 statement or whether the Panel would view it as a material change of circumstances.

In addition, it would be helpful to understand how the Panel would expect the reservations to be presented – will the announcement specifically need to refer to the potential offeror being restricted from conducting an assets transaction unless one of the exemptions applies?

Q15 Do you have any comments on the consequential and minor amendments referred to in paragraph 5.9?

No.

Q16 Do you have any comments on the proposed amendments to Note 1 on Rule 19.1, Rule 20.3 and Rule 20.4?

No – we welcome these proposed changes.

Q17 Do you have any comments on the proposed amendment to Note 5 of the Notes on Dispensations from Rule 9?

No.

Annex

Drafting comments on proposed new Rule 2.8 and Note 5 thereon

2.8 STATEMENTS OF INTENTION NOT TO MAKE AN OFFER

A person making a statement that it does not intend to make an offer for a company should make the statement as clear and unambiguous as possible. Other than with the consent of the Panel, unless circumstances occur that the person specified in its statement as being circumstances in which the statement may be set aside, neither the person making the statement, nor any person who acted in concert with that person, nor any person who is subsequently acting in concert with either of them, may within six months from the date of the statement:

…

(c) acquire any interest in, or procure an irrevocable commitment in respect of, shares of the offeree company if the shares in which such person, together with any persons acting in concert with it, would be interested and the shares in respect of which it, or they, had acquired irrevocable commitments would in aggregate carry 30% or more of the voting rights of the offeree company;

…

(f) purchase, agree to purchase, or make any statement which raises or confirms the possibility that it is interested in purchasing, directly or indirectly, assets which are significant in relation to the offeree company.

…

5. Significant asset purchases

(a) In assessing whether assets are significant for the purpose of Rule 2.8(f), the Panel will normally have regard to:

(i) the aggregate value of the consideration for the assets compared with the aggregate market value of all the equity shares of the offeree company; and, where appropriate; ***[It would be helpful to understand how earn-outs, deferred consideration and similar provisions would be addressed in assessing the consideration to be paid]***

(ii) the value of the assets to be purchased compared with the total assets of the offeree company (excluding cash and cash equivalents) ***[It would be helpful to clarify whether***

the bracketed wording applies to both the value of the assets to be purchased and the gross assets of the target]; and

(iii) the operating profit (ie profit before tax and interest and excluding exceptional items) attributable to the assets to be purchased compared with that of the offeree company.

For these purposes, "equity" will be interpreted by reference to Note 3 on Rule 14.1.

(b) The figures to be used for these calculations must be:

(i) for market value of the shares of the offeree company, the aggregate market value of all the equity shares of the company at the close of business on the business day immediately preceding the date of the proposed announcement of the purchase or agreement to purchase the assets, or the statement which raises or confirms the possibility that the person is interested in purchasing the assets; and

(ii) for assets and profits, the figures stated in the latest published audited consolidated accounts of the offeree company or, where appropriate, a subsequent preliminary statement of annual results or half-yearly financial report.

[It would be helpful to clarify how any non-cash consideration payable in connection with the asset sale would be valued]

Relative values of more than 50% will normally be regarded as being significant.