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The Secretary to the Code Committee
The Takeover Panel
One Angel Court
London EC2R 7HJ

By email to: supportgroup@thetakeoverpanel.org.uk

21 July 2023

Dear Secretary,

Panel Consultation 2023/1 ("PC23/1")
Comment from the Share Plan Lawyers Group ("SPL")

This letter contains the comments of SPL on PC23/1. SPL was formed by lawyers whose main practice is employee share plans. SPL has around 250 members, representing some 70 law firms, and a number of specialist practitioners. Our members include senior lawyers from the major UK firms.

One of the principal objects of SPL is to discuss matters of interest with public and private sector bodies and, where appropriate, to make submissions on behalf of members and their clients on issues affecting employee share plans.

Given SPL's role, we have concentrated on those elements of PC23/1 that relate specifically to employee share plans, being Questions 1, 2, 3, 10, 11 and 13.

Q1 Should the new definition of "restricted action" be introduced in the new Rule 21.1(c) as proposed?

We are broadly in favour of the expansion of the actions covered by the grant of options and awards from only those over newly issued shares to the grant of any options and awards over shares (i.e. even if satisfied by market purchase). This expressly places all companies in the same position in relation to all plans. Having said this, the grant of options or awards over market purchase shares already acquired and held by an EBT may well involve neither actual expense nor dilution for a company.

In cases where the grant of options and awards does involve the company incurring an expense, in one way or another, the position may already be covered by Rule 21.1(a)(iv) (agreeing to acquire/dispose of assets to a material extent).

Q2 Should issuing shares or convertible securities, granting options or awards over shares, or redeeming or buying back shares or convertible securities by the offeree company, other than in the ordinary course of business, in any amount be a restricted action, as proposed in the new Rules 21.1(c)(i) to (iii)?

The application of the restriction to grants of options or awards "in any amount" will limit small ad hoc grants that might be considered by the company to be commercially necessary but are not in the ordinary course. In some cases, it may be in the ordinary course to grant ad hoc options or

awards, e.g. to joiners. We think that it would be helpful to indicate that “normal practice” would include, depending on the facts of the case, both "what the company would usually do in the prevailing circumstances" (if they have arisen in the past) and "what the company has previously done in its annual award cycle". See also our comments in relation to Q3 below.

Q3 Should the current Note 5 on Rule 21.1 be amended as proposed with regard to employee incentivisation arrangements?

General

Yes. We agree with and echo the comment made by the Joint Working Party of the Company Law Committees of the City of London Law Society (CLLS) and the Law Society of England and Wales (the Law Society) (the “**JWP**”) that, as PC 23/1 notes, it is common for target boards to seek to grant options/awards in the ordinary course. As such, where this is consistent with normal practice it should be permitted as is the case under current Rule 21.1.

We understand, from paragraph 2.15 of PC23/1, that the Committee’s intention behind these amendments, is not to reduce Panel submissions in this area. It would still expect an offeree to consult the Panel to confirm that its intended actions were in the ordinary course (i.e. the Committee does not expect offeree companies to form their own view as to whether or not they are within the “ordinary course” carve-out). Instead, the Committee’s hope is the amendments will reduce the need for the offeree to notify or seek the views of the offeror as part of the process.

We suggest that the intention that offerees should consult the Panel to confirm that actions are in the ordinary course could be made clearer in new Rule 21.1(d). At present, the natural reading is that if the offeree believes its action is in the ordinary course (ie that the proposed action is not restricted), there is no need to consult the Panel (or the offeror).

The proposed changes will not ultimately remove the need for the offeree to provide details of outstanding share plan grants to the offeror for the purposes of planned share plan grants and settlements, where this is practical. This is because the offeror needs to understand (in detail and in real time) the value and nature of all outstanding share incentive interests in order (i) to price its offer, (ii) to seek required cash confirmations, and (iii) to formulate its appropriate proposals under Rule 15. The timing and nature of the engagement will vary depending on whether the transaction is recommended or hostile/competitive.

New schemes

We welcome the proposed approach in relation to the grant of options/awards under new incentive schemes but suggest that it should be widened to new forms of incentive that may not involve a new “scheme”. For example, a company may operate an Omnibus Plan, which allows for the grant of various forms of award (eg performance based grants and restricted share awards). It may be that circumstances prevailing prior to an offer period have led the company to consider and even to consult on the grant of a different form of award from its past practice, albeit under the same set of scheme rules. This widening would also help with awards made or to be made in order to buy out existing awards.

Where a new scheme is involved, and not simply a different form of award under an Omnibus Plan, it is possible to adopt and establish a plan without the need for shareholders’ approval where directors are not eligible to participate and awards can only be satisfied with market purchase shares.

In both of these cases, we think that it would be useful to extend "ordinary course" to new awards details of which had not been publicly disclosed (eg circulated to shareholders) but which had been substantially progressed (prior to the relevant period).

Additionally, in circumstances where the proposed practice under a new scheme has not been publicly disclosed before the start of the relevant period, it would be helpful to understand whether the Panel may still treat the grant of options/awards as ordinary course where this is consistent with the offeree's past practice under prior schemes.

It would be useful if it were made clear that cash-based incentive plans were covered by the same provisions and exemptions.

It would be helpful to include guidance on a situation where there has been board approval of an option grant before the start of the relevant period but no further action has been taken. In circumstances where the subsequent award decision would not (for some reason) fall within new Note 1, we consider that the action would have been partly implemented and therefore permitted under Rule 21.1(e)(v). Paragraph 6.3 of draft PS34 suggests that a board decision would normally be insufficient, but we do not think that the same analysis should apply in the context of share awards.

Notes

In relation to the drafting of new Note 1:

• We suggest that that the word "Employee" is removed from the title of the Note and from Note 1(c), as these provisions should extend to non-executive directors and other personnel and service providers (e.g. consultants) who are not strictly employees.

• We also suggest that Note 1(a)(i) and (ii) should refer to incentive schemes (rather than share incentive schemes) to make it clear that it covers incentive structures other than options and LTIPs, etc. – for example, annual bonus plans that require bonus deferral into shares.

• In Note 1(b) it would be helpful to clarify, in addition to the current note, that the delivery of market purchase shares (and the funding of such purchases, for example via a contribution to an employee benefit trust) would similarly be considered ordinary course.

It would be helpful if a Note were added to make it clear that the Panel would disapply Rule 21.1 in relation to the use of market purchase shares where there is neither dilution nor expense.

Q10 Should the Panel be consulted to determine whether entering into offer-related employee retention arrangements that relate to a period that is prior to the end of the offer period would be a restricted action, as proposed in the new Note 1(c) on Rule 21.1?

We are not clear as to whom the Panel considers to be "senior management" (would this be, for example, anyone who reports directly to the CEO or Chair?) and whether, and if so why, this would differ from "management" for the purposes of Rule 16.2. We think that the class should be the same under both Rules, and that it would comprise directors and PDMRs.

In general, this change is unlikely to affect the advice that is already given by our members. However, we question the restriction on arrangements for senior managers even if not significant (thus excluding them from a more broad-based arrangement that is not "significant"). Directors of most companies which are covered by the Code will be subject to a remuneration policy approved by shareholders.

We draw your attention to circumstances in which part of an existing share incentive award that would not otherwise vest (e.g. due to time pro rating) is replaced with an equivalent cash award which will vest on a retention-only basis. Arguably, the cash award does not apply to a period prior to the end of the offer period because the existing award remains in place unless and until the offer succeeds. The Offeror will already have taken the existing award into consideration when determining the offer, so the replacement should not be seen as a frustrating action. It simply converts one type of award into another of equivalent value.

Again, we agree with the JWP that it would be helpful to understand the Panel's approach where arrangements relate to a period that is partially before and partially after the end of the offer period, and the JWP's example of retention arrangements that may be structured to pay out in 12 months' time, irrespective of when the offer completes or (if earlier) 3 months following completion of the offer.

Q11 Do you have any comments on the circumstances in which the Executive may consider entering into offer-related employee retention arrangements to be a restricted action, as set out in the draft new Practice Statement No 34?

As regards Section 5.3(e), we note that as the arrangements are, by definition, outside the ordinary course of the offeree's business, and are very likely being introduced to address the impact of the offer or potential offer on business stability, the concept of "normal practice in the relevant industry or sector" is unlikely to be a relevant factor.

It is currently common practice for offeree and offeror companies to agree that a certain amount of money (i.e. an unallocated cash bonus pool) can be used by the offeree in its discretion for cash based retention (with the offeror agreeing that it would not regard use of cash up to the agreed amount to be frustrating action). It would be helpful to understand the Panel's perspective on approval of an unallocated cash bonus pool, given that the factors set out in Section 5.3(b)-(f) would be unlikely to be known quantities.

In relation to Section 5.3(g), what would be the context of the views of the Rule 3 adviser?

Q13 Should the restrictions in Rule 21.1(a) apply during the "relevant period", as specified in the proposed new Rule 21.1(b)?

Defining the "relevant period" assists in clarifying exactly when the restrictions start and end.

Contact with SPL

If you have any questions on the above, please contact either Paul Randall of Hogan Lovells at paul.randall@hoganlovells.com or Hannah Needle of Tapestry Compliance at hannah.needle@tapestrycompliance.com.

Yours faithfully

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