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March 2011

# Proposed Changes to the UK Takeover Regime

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## Introduction

The Takeover Panel (the "Panel") has issued its eagerly-awaited consultation paper setting out the details of its proposed changes to the UK takeover regime.

The paper follows the Panel's review last year of certain fundamental aspects of the UK takeover regime, which in turn followed the highly politicised debates arising out of Kraft's takeover of Cadbury in early 2010. Whilst some of the more controversial proposals initially put forward in the original consultation (such as disenfranchisement of certain shareholdings and raising the offer acceptance threshold) are not being taken forward, the changes arising out of that review and as now set out in detail in the recent paper will significantly alter many aspects of UK market practice once introduced.

Although the paper that has been released is a consultation paper, we do not expect that there will be any significant changes or deviations from the position now proposed by the Panel, other than points of drafting or detail. The consultation period ends on 27 May 2011 and we expect the changes will take effect in the second half of 2011. A copy of the Panel's consultation paper can be found here.

## Key Changes

The principal changes to the takeover regime, which are considered in more detail below, are as follows:

1. Mandatory disclosure of potential offerors in all takeover-related announcements;
2. An automatic 28-day "put up or shut up" period;
3. Prohibition of deal protection measures, including break fees;
4. Increased transparency and disclosure requirements, including as to advisers' fees; and
5. Greater recognition of the interests of the target company's employees.

## Background

Following last year's review and consultation process, the Panel's conclusion was that the balance of power between an offeror and offeree in the UK had swung too heavily in favour of the offeror, which was able to use the takeover regime and market practice to both gain a tactical advantage in the early stages of a transaction and to obtain certain "deal protection" terms. The Panel's conclusion was that amendments to the City Code on Takeovers and Mergers (the "Code") should be proposed to redress the balance in favour of the offeree. It also found that a number of other changes should be introduced to the Code to improve the offer process and to take further into

account the position of other stakeholders who are affected by takeovers in addition to offeree company shareholders.

## Impact of the Changes

Details of the key proposed changes and the likely impact we expect them to have on UK market practice are as follows:

### *1. Mandatory Disclosure of Potential Offerors*

Currently, if the fact that a takeover is in contemplation leaks and an announcement is required, that announcement needs to identify the offeree company, but not necessarily the offeror. The Panel's concern is that a leak can lead to unwanted disruption to an offeree company, whilst the offeror could remain relatively unaffected.

Accordingly, the Panel is proposing that (other than in the context of a public auction) where there is an announcement by an offeree company which commences an offer period, that announcement should identify any potential offeror with whom the offeree is in talks or from whom it has received an approach.

Whilst secrecy has always been a fundamental principle within the UK's takeover regime, it is likely that this change, together with the automatic 28-day "put up or shut up" period discussed below, will renew and enhance potential offerors' focus and attention on confidentiality and the avoidance of leaks in the early stages of a deal.

### *2. Automatic 28-Day "Put Up or Shut Up" Period*

Under the current regime, once a potential offer is announced, there is no automatic time limit imposed as to when the offeror would need to either make a bid or withdraw. This has led to the concern that it is too easy for a target company to come under siege from a potential offeror under a "virtual bid", whereby the potential offeror would announce that it is considering making a bid without committing itself to do so. Whilst the Panel could impose such a time limit on a potential offeror under the current regime, this would need to be at the request of the offeree company, and the Panel's concern is that it can generally be perceived as a defensive move for an offeree company to make such a request.

Accordingly, the Panel is proposing that the "put up or shut up" deadline would be automatically set at 28 days following a potential offeror being publicly identified, by which time that person would need to either:

- announce a firm intention to make an offer;
- announce that it does not intend to make an offer, in which case they would be prevented from making an offer for that target at any time within the next six months; or
- together with the offeree company, seek an extension.

Again, this would not apply in the context of a public auction.

Along with the increased focus on secrecy, we expect that this will also have the effect of potential bidders being required to do a lot more work up front in the early stages of a transaction. This is likely to be of particular importance in the context of complex, cross-border acquisitions and on transactions where potential bidders would be reliant on having financing in place prior to announcing an offer (including, notably, private equity). We also expect that the decision by an offeror to approach (which, it should be noted, can take a range of forms from formal offer letters

to informal discussions between principals) will be more considered and cautiously made than may have previously been the case.

### *3. Prohibition of Deal Protection Measures*

Market practice in the UK has been established such that it is expected and standard in a public company acquisition that there will be various deal protection measures agreed to by the offeree, including a break fee (currently generally allowable if up to 1% of the value of the offeree company). The Panel's concern is that deal protection measures might deter competing offerors from making an offer and/or lead to competing offers being on less favourable terms than they otherwise would have been.

Accordingly, the Panel is proposing that substantially all deal protection measures in the context of a UK offer should be prohibited, other than break fees in favour of a white knight, where the target board initiates a public auction or in certain situations where the target is in financial distress. The only contractual obligations to which the Panel envisages an offeree should have to commit are:

- to preserve the confidentiality of information;
- the non-solicitation of an offeror's employees or customers; and
- the provision of any information required to satisfy the offer conditions or regulatory approvals.

This change will make a distinct difference to market practice in the UK and the blanket prohibition of break fees may come as a surprise for offerors from other jurisdictions, particularly, for example, the United States, where these arrangements are more commonplace. It is possible that alternative mechanisms for improving deal certainty, such as stakebuilding and irrevocable undertakings (which, in general, tend to be of more use in contractual offers as opposed to schemes of arrangement) will be increasingly considered in the early structuring stages of a deal. In addition, takeovers effected by way of schemes of arrangement, which are target-led processes typically carried out under an implementation agreement, will now be governed solely by new takeover rules introduced for this purpose.

### *4. Increased Transparency and Disclosure Requirements*

The additional disclosures that the Panel will require going forward mean that certain offerors' financial statements will need to be disclosed in the offer document for all offers and not just offers in consideration for securities (which was historically the position). In addition, there will be a requirement for fuller disclosure of financing arrangements and certain financing and other documents will now need to be put on display for all offers at the time of announcement of a firm intention to make an offer.

In addition, and of more relevance for market practitioners, the Panel is going to require disclosure in the offer document and offeree board circular of offer-related fees and expenses. This will include an estimate of the aggregate fees and expenses incurred for advisers, broken down by category (i.e. financial advisers, financing, legal advice, accounting advice, public relations agents, etc). It can be expected that this will lead to increased public and media scrutiny of advisers' fees, particularly in the context of high-profile public transactions.

### *5. Greater Recognition of the Interests of the Target Company's Employees*

Going forward, the Panel will require offerors to state in the offer document not only their future plans regarding a target's employees, locations of business and fixed assets, but also to state if it has no such plans. Further, both the offeror and offeree will be required to adhere to any public

statements they make throughout the offer period in respect of their intentions after the end of the offer period. Unless the relevant party specifies a time period in which it will take or not take any action, the Panel will expect the statement to hold true for at least a year following the offer becoming wholly unconditional. This is a direct consequence of the issues arising out of the Kraft / Cadbury takeover, which led to the Panel issuing a public criticism of Kraft in respect of its statement of intention to keep Cadbury's Somerdale factory in the UK operational.

The Panel has proposed a new definition of "employee representatives" to reiterate that the offerors and offerees are each under an obligation to communicate with trade union representatives and employee representatives of the respective companies where two bodies are recognised across the same workforce or, where there are none, the employees themselves. In addition, the Panel is proposing to make changes to improve the ability of employees to make their views on the offer known. Going forward, the offeree company would be required to notify employee representatives of their right to circulate their opinion on the effects of the offer on employment, pay for the costs reasonably incurred by the employee representatives in obtaining advice on it and circulate that opinion at its own cost. Where the employee opinion is not received in sufficient time to publish with the offeree board circular, or is received after the publication of the offeree board circular but within 14 days of the offer being declared unconditional, there is a new obligation on the offeree to publish the opinion on a website and put out an RIS announcement.

Again, in light of these changes and the lessons learnt from the Kraft / Cadbury offer, it is expected that any potential offeror's plans for the target business and employees, including any integration, restructuring and redundancy exercises, will need to be more strategically thought through from an earlier stage if it wishes to avoid being caught by the default one year moratorium. It is also likely that the public statements of both offerors and offerees on the future of each company and their employees will be subject to increased verification and scrutiny.

*If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings London lawyers:*

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