

U.K. Takeover Code – Changes Effective September 19, 2011

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“Takeover Rules Force Companies to Open Up,” “Shake-Up in M&A Clarifies Takeovers”

Kraft’s bid for Cadbury generated widespread debate in the U.K. among market participants, politicians and the general public about whether it is too easy for hostile bidders to take over U.K. companies. Against that backdrop, the much-anticipated amendments to the U.K. Takeover Code (the Code), designed to redress the perceived tactical imbalance favouring bidders, came into effect on September 19, 2011. Announcements released by target companies on September 19 provide early indications that the headlines (such as the two quoted above) have overstated the immediate impact of the new rules. Only time will tell the true impact, as both market participants and the Takeover Panel (the Panel) adapt to the “new normal.”

The new rules closely follow the proposals set out by the Code Committee of the Panel following its 18-month public consultation¹. In addition, on September 19, the Panel published a number of amendments to historical Panel guidance relating to the application of certain rules of the Code, which are critical to understand how the Panel will apply the new rules.

Identification of Potential Bidders and the 28-Day Offer Deadline

Except possibly for the banning of deal protections (such as break fees), the most significant change to the Code is the new requirement that an announcement of a possible offer released by a target must, subject to limited exceptions, identify all bidders who have made an approach and not been rejected. In order to prevent false markets arising, such announcements are required by the Panel where it takes the view that there has been a leak, typically evidenced by an untoward movement in the target stock price, or rumour and speculation. Named bidders are now required to make a bid or walk away within 28 days unless the target and the Panel agree to an extension of that deadline.

During the public consultation on the rule changes, market participants and commentators expressed concerns that these requirements could reduce the number of approaches made to U.K. targets or kill deals, as bidders who are unwilling to be exposed terminate talks to avoid disclosure. Market participants also have expressed concerns that the 28-day deadline could have serious consequences, particularly with respect to the financing of bids. Under the Code, when a cash offer (or one containing a cash element) is announced, the bidder’s financial advisor must confirm publicly that the bidder has the resources required to satisfy full acceptance of the offer. To give such a confirmation, if any of the cash element is to be debt funded, financial advisors require that any lending arrangements be progressed to a “certain funds” stage. This can be challenging both pre-announcement (where the number of external parties, including lenders, who can be spoken to is limited in order to maintain secrecy) and post-announcement within the new 28-day deadline.

¹ See “Backing the Target Board: Proposed Changes to Rebalance UK Takeover Rules,” Skadden, Arps, Slate, Meagher & Flom LLP, June 21, 2011

In July, the Panel published transitional arrangements, which required all targets that were in play to name the bidder or bidders on or before September 19, thereby setting a deadline for them to make a bid or walk away by 5 p.m. on October 17 (28 days later).

Announcements released on the morning of September 19 give an early indication as to the impact of these new rules. Whilst the bulk of the announcements were to confirm that processes were ongoing with previously named bidders and noting that the new 28-day deadline would apply, the following observations are notable:

- (i) four announcements relating to previously announced strategic reviews were released, none of which identified a possible bidder. Two were not required to do so (one apparently on the basis that it was conducting a formal sale process and one pursuant to a dispensation from the Panel, which appears to have been granted on the basis that the approach and announcement pre-dated the guidance discussed below²) and two had not attracted any bidders;
- (ii) one announcement relating to a previously announced possible management buyout (Parseq Plc) was released, identifying the financial backers in addition to the previously identified leader of the MBO, the company's chairman;
- (iii) only one announcement (Travelzest Plc) was released identifying a previously unnamed bidder (Red Label Vacations Inc.); and
- (iv) there were no announcements that talks with previously unnamed bidders had been terminated.

On September 19, the Panel amended previous guidance relating to leaks announcements to conform to the new rules and remove loopholes that market participants may have thought could be used to avoid the new requirements. In summary, these were:

- (i) where a company announces a strategic review after it has received an approach, the possible bidder who had made an approach must be named;
- (ii) any attempt by a bidder to restrict the target publicly announcing its identity (for example, by stating that the approach will be withdrawn automatically if an announcement is required or if the target does not engage in discussions within a specified period of time) would be in breach of the Code; and
- (iii) where an announcement would trigger an offer period but would not identify the bidder because the approach has been rejected, the Panel must be consulted.

Documents on Display

Rule 26 of the Code has been amended to require the following documents to be put on display on the bidder's website by 12 noon (London time) the day after a firm offer is announced under Rule 2.7 (formerly Rule 2.5) of the Code:

- (i) irrevocable commitments or letters of intent procured by the bidder or the target;

² In the event, speculation generated by the announcement forced the target (Arena Leisure Plc) to announce the identity of the possible bidder (the Reuben Brothers).

- (ii) unredacted financing documents of the kind required to be described in the offer document (see Increased Disclosure, below);
- (iii) any indemnity or other dealing arrangements which induce any person to deal or refrain from dealing in the securities of the bidder, the target or any competing bidder; and
- (iv) any permitted offer-related arrangement (see Banning Deal Protections, below).

Increased Disclosure

Offer documents will now be required to include greater disclosure in a number of areas, a change designed to put the target board, shareholders and employees in a better position to judge the merits of a bid. The market will be watching closely how this practice develops, with a particular focus on the bidder's statements of intention regarding the target (to which it will now be held, for a period of 12 months, unless a different time period is specified (Rule 19)), plans regarding the target business (new Rule 24.2 (old 24.1)) and financing of the offer (Rule 24.3(f)).

The new rules require a more detailed description of the financing arrangements in the offer document and the description now must cover arrangements relating to the refinancing of existing debt or working capital facilities of the target in addition to the financing of the bid itself. The Panel has made it clear that headroom in a financing, which may allow a bid to be increased, need not be described (and hence should be contained in a side letter or other collateral agreement so as not to be put on display) and that the obligation is to display debt facilities themselves. The Panel will not require granular descriptions of equity funding structures (which may include debt and preferred share capital) provided by funds of the sponsor to private equity bidding vehicles.

Banning Deal Protections

The Panel has adhered to its previously announced hard line regarding deal protections and banned, except in very limited circumstances, "any agreement, arrangement or commitment proposed to be entered into in connection with an offer, either during the offer period or when an offer is reasonably in contemplation." This will remove a number of contractual protections familiar to bidders, such as break fees, as well as information and matching rights. Limited exceptions are available for confidentiality, employee retention, provision of information for regulatory purposes, as well as irrevocable commitments and letters of intent to accept an offer given by target directors in their capacity as shareholders. The rules will not restrict the bidder from undertaking any obligations to the target, such as a reverse-break fee or standstill agreement.

A Proportionate Rebalancing of Power?

Market practices will develop in response to the new regulatory landscape. As a principles-based system, it will be important to see how the Panel applies the new rules to particular deals. Only then will we know whether the intended shift in the balance of power away from hostile bidders and toward target boards is an effective and proportionate response to concerns raised following Kraft's bid for Cadbury, or whether the changes have gone too far and unnecessarily inhibit deal activity in the U.K. As of September 20, there was little evidence of a seismic shift.