

Public Takeover Offers



An introductory guide to public company takeovers (including leveraged/management buy outs) in the United Kingdom

Updated edition

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Introduction

This publication summarises some of the key commercial and legal aspects relating to the acquisition in the United Kingdom of a company which is publicly listed or quoted in London.



Taylor Wessing Equity Capital Markets Group

About the Equity Capital Markets Group of Taylor Wessing

The "highly regarded" * corporate practice of Taylor Wessing and, in particular, the Equity Capital Markets Group puts its lawyers at the centre of transactions. The Equity Capital Markets Group has advised on many public company bids and is expert at undertaking, managing and successfully concluding such transactions for its clients.

The Equity Capital Markets Group is a specialist group within the firm's Financial Institutions and Markets Group and comprises corporate lawyers with many years' experience of working in the field of securities law. Given the close relationships developed between Taylor Wessing's corporate lawyers and their corporate clients, it is expected that securities lawyers work in more than one corporate practice area.

Across Europe, Taylor Wessing has one of the largest securities practices. The Equity Capital Markets Group represents issuers, investment banks and stockbrokers across all types of European and global securities offerings. The Group also advises on takeovers, restructurings and every type of securities offering whether involving equity, debt or other securities.

* Legal 500



The Code

The Panel on Takeovers and Mergers (the "Panel") polices the City Code on Takeovers and Mergers (the "Code"), which sets out the main rules relating to offers for public companies.

At present, the Code does not have the force of law, but compliance with it is effectively obligatory for a company's advisers and for any company wishing to be regarded as a reputable player in the UK corporate area.

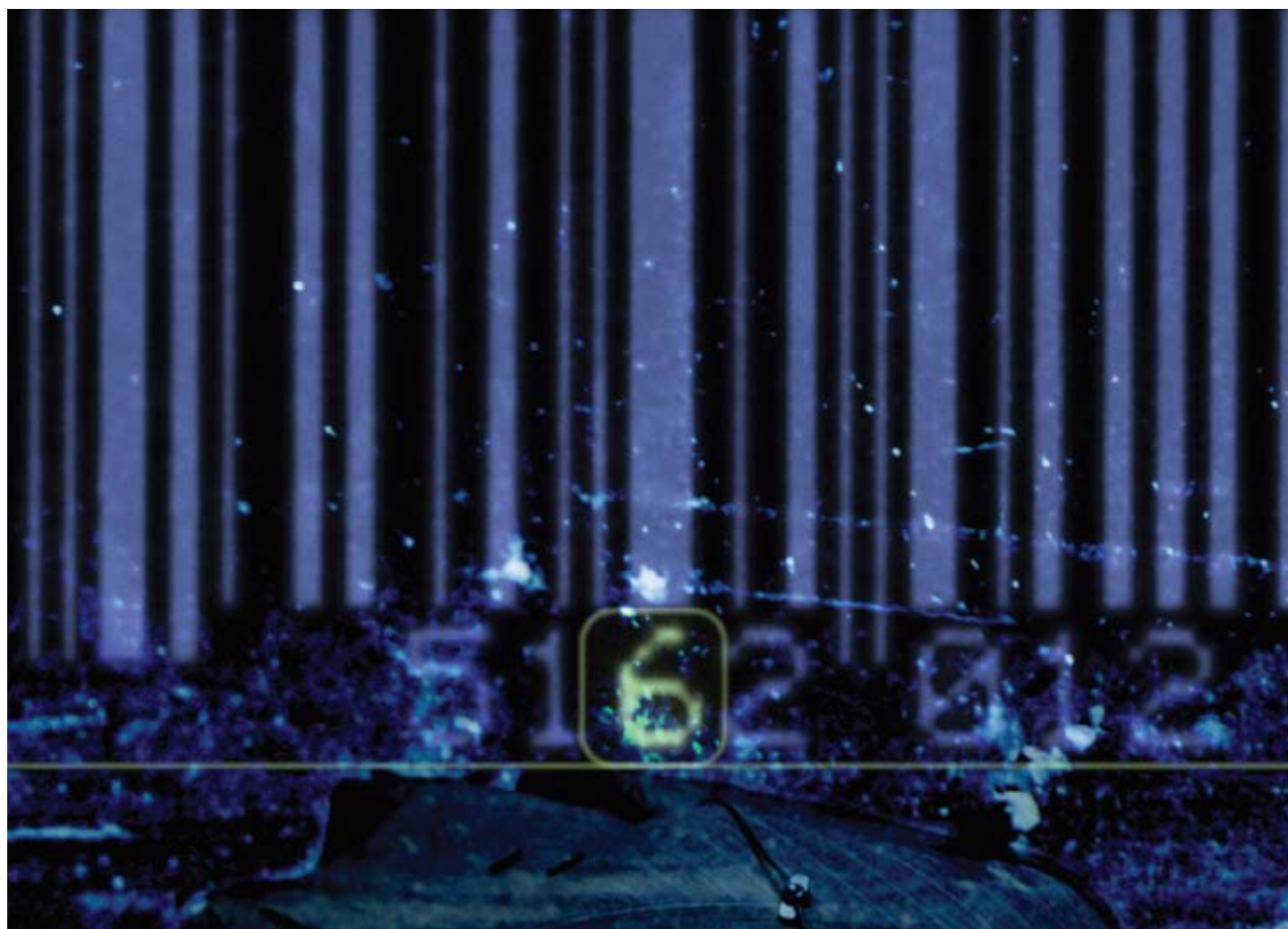
Following the implementation of the EU Takeover Directive in the UK in May 2006, takeover regulation and the Panel were placed on a statutory footing. The Panel therefore now has statutory power to make its rules relating to takeovers in the UK and can seek enforcement of the Code and its rulings by the UK courts. The Panel also has authority to request that the Financial Services Authority ("FSA") take enforcement action if a company's behaviour amounts to market abuse for the purposes of the Financial Services and Markets Act 2000 ("FSMA").

The Code has three key principles:

- all target company shareholders are to be treated equally
- target company shareholders should be given the appropriate information so as to enable them to decide whether or not to accept an offer, and
- no steps should be taken by a target company which would prevent or hinder an offer being made to its shareholders.

The other main themes running through the Code are set out in the appendix to this guide.

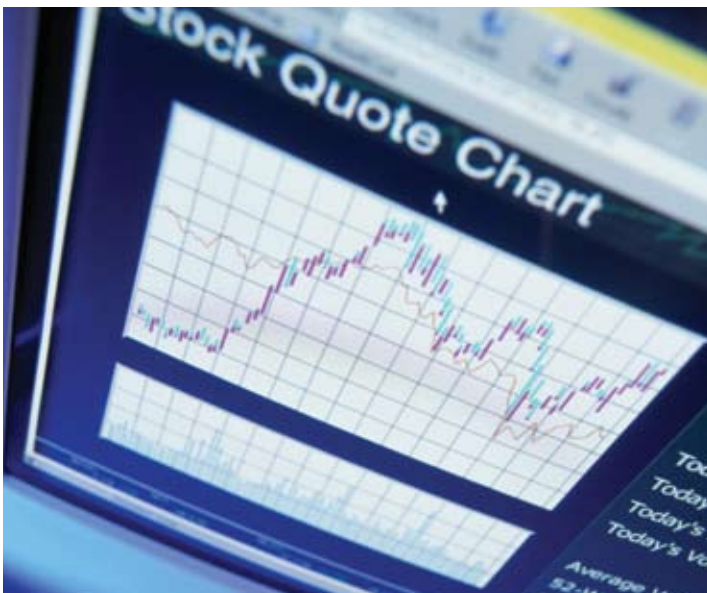
The Code applies to all types of takeover transactions, including offers for part or all of the share capital of a company. Any company which has its registered office in the UK, the Channel Islands or the Isle of Man, and which has any of its securities admitted to trading on a regulated market in the UK or on an exchange in the Channel Islands or in the Isle of Man, will be subject to the Code. Companies not fulfilling all of these criteria may still be subject to the Code in certain circumstances.



Legislation

Certain legislative provisions are also particularly relevant to public company takeovers. The key ones are:

- the Companies Act 2006 ("CA06"), for example providing a statutory mechanism for implementation of the EU Takeover Directive and providing for the compulsory acquisition of minority shareholdings in takeovers
- the Companies Act 1985 ("CA85") - pending its phased repeal as it is replaced by CA06 in the period up to October 2009
- the Criminal Justice Act 1993 relating to insider dealing
- the Financial Services and Markets Act 2000 ("FSMA") which regulates the conduct of investment business and activities such as advising on and arranging transactions in securities and contains prohibitions on market abuse and market manipulation
- the Competition Act 1998 (the relevant provisions of which are designed, broadly, to control the establishment of monopolies and restrict anti-competitive practices) and the EC Merger Regulation, and
- the Disclosure Rules and Transparency Rules ("DTRs") - requiring disclosure of dealings in the target company's shares.



Rules relating to share stake building exercises

The Code and the DTRs of the UK Listing Authority, the Criminal Justice Act 1993 and FSMA all contain restrictions on stake building exercises, ie, how many shares in a target company can be acquired and over what periods and disclosure of the resulting shareholdings.

The Code

A party (or parties acting in concert) who acquires interests in 30 per cent of the interests of a company is required to make a mandatory offer for that company. A party owning less than 30 per cent may not acquire interests in shares so as to control more than 30 per cent except in specific circumstances. A party already owning between 30 and 50 per cent may not increase its shareholding, again except in specific circumstances. Dealings in target company shares by parties and their associates must be disclosed by 12 noon on the following business day. Anyone who owns or will own more than 1 per cent of such shares must also disclose any dealings during an offer period.

A bidder is obliged in any bid which it decides to make to offer all target shareholders the highest price at which it purchased target shares at any time during the period of three months prior to the making of the bid. A bidder which subsequently acquires further target shares during the offer period at a higher price, must increase its bid price to that higher price.

A cash offer must be made to target company shareholders if a bidder has bought more than 10 per cent of the target's shares before or during the bid.

Directors and financial advisers are not permitted to deal in target company shares during an offer period without prior notice.

The Disclosure Rules and Transparency Rules

Under the DTRs (which apply for these purposes to AIM-quoted as well as Official List companies), any person having an interest in shares, or through his or her indirect or direct holding of certain financial instruments must notify the company of this interest if the percentage of voting rights attached to it reaches, exceeds or falls below 3 per cent, 4 per cent, 5 per cent, 6 per cent, 7 per cent, 8 per cent, 9 per cent, 10 per cent and each 1 per cent threshold thereafter up to 100 per cent as a result of an acquisition or disposal. This applies only to movements of whole percentage points above per cent. Certain concert party interests are included in the total. However, voting rights attached to certain shares are disregarded for the purposes of determining whether a person has a notification obligation in accordance with the thresholds above.

Concert parties

Parties who decide to act together in connection with a proposed bid, whether by the acquisition of shares in a target company or otherwise, will be regarded as one party for the purposes of applying the share acquisition limits and mandatory bid provisions of the Code. The Code defines "acting in concert" extremely widely and it is not necessary for a legally binding agreement between parties to have been entered into before a concert party could be regarded as existing, in other words, informal arrangements or agreements will suffice.

Insider dealing

Insider dealing legislation and the Code make it unlawful for any person, other than the bidder itself, who is aware of a proposed bid to buy shares in the target company until there has been an announcement either that the bid is to be made or that bid negotiations have been terminated.

Market abuse

FSMA contains civil offences that mirror the insider dealing offences as well as a civil offence concerning various forms of market manipulation.

The bidder and target company must ensure that they do not enter into transactions (otherwise than for legitimate reasons) that give a false or misleading impression as to the price of securities or result in those securities trading at an abnormal or artificial level. There is a presumption that transactions made in the course of a takeover which are entered into in accordance with the Code and which conform with the principles of the Code are for a legitimate reason and, as such, are not an offence.

There is a lower burden of proof for market abuse offences as opposed to any similar criminal offences under the insider dealing legislation. However, an alleged offender would not be prosecuted under both regimes.

Key percentages

The following table highlights the main impact of acquiring certain key percentages of a target's share capital.

Percentage of shares or voting rights in target	Implementation
1 per cent	dealings during an offer period to be disclosed by noon on the following day
3 per cent	notify target company within two business days
10 per cent +	can block a "squeeze out" - see page 14
10 per cent in a year	if purchased for cash, any subsequent offer must be in cash or accompanied by a cash alternative at the highest price paid
30 per cent	acquisition of 30 per cent or more will give rise to a mandatory bid requirement
50 per cent +	power to appoint/remove directors offer can be declared unconditional as to acceptances
75 per cent +	required majority to approve a special resolution
90 per cent	power to compulsorily acquire or "squeeze out" shares held by non-assenting minority shareholders

Preliminary issues

Due diligence

A bidder will want to investigate the business and affairs of a target in as much depth as possible, particularly so when it is raising finance to support its bid.

Two issues commonly result in any due diligence exercise being much more limited - although the precise scope will be a question of negotiation - than would be the case with the acquisition of a private company. First, the Code imposes an obligation on a target company, its directors and their advisers to keep the prospect of a potential bid absolutely confidential. This, of necessity, will mean keeping the number of target personnel involved to the absolute minimum and will thus reduce the extent of the information which can be supplied. Secondly, whilst a target company may be happy to disclose information in confidence to a "friendly" bidder, the Code will require it to disclose the same information to any other bona fide potential bidder - including a potential competitor - who comes along subsequently.

Target board recommendation

A bid which is recommended by a target board will, price considerations aside, generally be more likely to succeed than a bid which is not so recommended. It is also likely to be a cheaper and less risky exercise; cheaper in that the costs of mounting a hostile bid, in terms of success fees to advisers and bank financing arrangements, are generally greater and less risky in that greater due diligence should be possible in the case of a recommended bid.

The decision as to whether or not a bidder is prepared to "go hostile" is something which needs very careful consideration at an early stage.



Pre-offer stage

Communicating and implementing the offer

The Code requires that an offer be put, in the first instance, to the target board or to its advisers. The target board is entitled to be satisfied that the bidder has the necessary resources to implement the bid and as to the identity of the ultimate parent of the bidding group. In particular, the target company will wish to see that the drawdown of any bid finance is unconditional save as to the satisfaction of the conditions actually attaching to the bid, as set out in the offer document.

Pre-bid announcements

The Code requires an announcement to be made when the target becomes the subject of rumour and speculation, or when there is an untoward movement (usually taken to be at least 10 per cent) in the share price. The obligation to make an announcement rests with the bidder prior to the approach and, primarily, with the target company thereafter.

A denial of an intention to bid is treated with great importance and announcements expressing such an intention not to make an offer are required to be as clear and unambiguous as possible. A person will normally be bound by such a statement. A change of intention after such a statement would only be permissible within six months of such statement if the Panel was satisfied that a material change of circumstances has occurred sufficient to justify the change of intention or that an event specified in the announcement as an event which would enable it to be set aside has in fact occurred. In considering the application of this rule, the Panel will take into account not only the statement itself but also the manner of any public reporting of it.

A firm intention to bid should only be announced when the bidder has every reason to believe that it can and will continue to be able to implement the offer. Responsibility in this regard also rests on the bidder's financial adviser. The announcement of a firm intention to bid must contain detailed information as to the terms of the offer and the bidder's holdings in the target. Once a bidder has announced a firm intention to bid it must go through with its offer and a change in general economic, political or industrial circumstances, for example, will not justify a failure to proceed.

Virtual offers

Over the past few years, bidders have increasingly made what have become known as "virtual offers" - that is, where a potential (often unwelcome) bidder announces that it is considering making an offer for a company, subject to certain conditions, often following press or market speculation.

Virtual offers can be used by a potential bidder to get a feel for how the market, the target shareholders and employees and also any potential competing bidder would react to a bid. However, as virtual offers can introduce uncertainty into the market, the Panel requires a potential bidder who has announced a virtual offer to "put up" (announce a firm intention to make an offer) or "shut up" (announce that it has no intention to bid) within certain time limits. Recent changes to the rules relating to announcements have also tightened up the rules for these practices.

Break fees

It is increasingly common for the target company to agree to pay some or all of the abortive professional and other costs of the bidder if certain specified events occur and which have the effect of preventing the offer from proceeding or causing it to fail (for example, the withdrawal of a recommendation by the target board following a higher competing offer from a third party).

Agreeing to pay such a break fee or inducement fee potentially constitutes an unlawful indemnity for the purposes of the legislation prohibiting financial assistance. To ensure that the proposed break fee is not an indemnity, the fee should be a fixed amount and not one which is precisely calculated according to the bidding vehicle's actual ultimate costs.

There is also an argument that, if the payment of a break fee would result in a "material" reduction of the market value of the target's assets (or if the target does not actually have any net assets), this would by itself constitute unlawful financial assistance, even though it were not an unlawful indemnity. It is thought, although there is no statutory guidance, that a 1 per cent reduction in the target's net assets represents the upper limit of the range as to what is material.

The Panel is concerned to ensure that a target company's shareholders are not adversely affected by break fees and that these should not frustrate a bona fide counter-offer. As a result, the Code provides that:

- break fee agreements must be disclosed in the bidder's press announcement and offer document and be put on display for inspection
- break fees should be less than 1 per cent of the offer value (calculated on the basis of the fully diluted equity share capital and taking into account any VAT payable, except to the extent that such VAT is recoverable), and

- the target's financial adviser needs to give the Panel (at the earliest possible opportunity) full details of the fee and satisfy it that the fee is commercial and appropriate.

The break fee should not be expressed to be payable in the event that the target is in breach of an obligation. A fixed payment to compensate an innocent party following the other's breach of contract will generally be unenforceable as a penalty as it will bear no direct relevance to the innocent party's actual loss. The payment of a fee on a specified event which does not involve a breach - for example, on a withdrawal of a recommendation - should not constitute a penalty, because there is no breach of contract.



Offer conditions

The acceptance condition

For any offer that could result in the bidder holding more than 50 per cent of the voting rights of the target, it must be a condition that the offer will not become or be declared unconditional as to acceptances unless the bidder has acquired or agreed to acquire (by virtue of the offer or otherwise) shares carrying more than 50 per cent of the voting rights. If the target company has more than one class of equity, then the Code provides that the bidder must make a comparable (and separate) offer for each class whether such class carries voting rights or not.

When a cash offer is required

If shares carrying 10 per cent or more of the voting rights of any class included in an offer have been purchased for cash by a bidder or any person acting in concert with it during the offer period and within the previous 12 months, the bidder must offer cash for that class or a full cash alternative at not less than the highest price paid in that 12 month period.

When a securities offer is required

If shares carrying 10 per cent or more of the voting rights of any class included in an offer have been purchased by a bidder or any person acting in concert with it in exchange for securities in the three months prior to the start of the offer period and during it, then the bidder will normally be required to offer securities to other holders of that class.

Other conditions

A voluntary offer may be subject to any condition which the bidder sees fit to include, except for conditions which depend solely on subjective judgements by the bidder, or the fulfilment of which is in its hands. The conditions in a voluntary offer generally relate to certain actions or events which must have occurred or taken place prior to the offer becoming unconditional (for example, bidder shareholder approval) and/or provide safeguards against a wide range of specific adverse events occurring during the offer period. Conditions may be waived by the bidder rather than specifically fulfilled but the Panel will only allow a bidder to invoke a condition to lapse an offer if it is material and significant in the context of the offer. This is a very difficult hurdle to overcome.

Where a reference to the Competition Commission or by the European Commission ("EC") is possible, it must be a term of the offer that the offer will lapse if there is a reference or if proceedings are initiated before the first closing date or the date on which the offer becomes or is declared unconditional as to acceptances, whichever is the later.

Mandatory offers

When a person (or persons acting in concert) acquires an interest which carry 30 per cent or more of the voting rights of a company or when a person already holding between 30 and 50 per cent of the voting rights acquires additional shares which increases its percentage of the voting rights, that person must make a "mandatory offer" to all shareholders. Exceptions to this obligation are possible only in very limited circumstances. In addition, the conditions to which a mandatory offer may be subject are limited to:

- acceptances being received in respect of shares which, together with shares already acquired or agreed to be acquired, will result in the bidder and those acting in concert with it holding shares carrying more than 50 per cent of the voting rights, and
- the possibility of reference to the Competition Commission or the initiation of proceedings by the EC.

Mandatory offers must be in cash (or with a full cash alternative), normally at not less than the highest price paid by the bidder for shares of that class during the offer period or within the previous 12 months.



Bid timetable

A bid, whether welcome or not, distracts the target company from its day-to-day business. In order to minimise this disruption while allowing the shareholders sufficient time to decide on the merits of an offer, the bid timetable sets out rules as to when certain events have to have happened and time periods before which certain events cannot occur. The timetable is summarised below (days include all days and do not refer to business days).

- DAY 0 Posting of the offer document to the target's shareholders. This must be done within 28 days of the announcement of a firm intention to make an offer, but is usually done sooner.
- DAY 0 - 14 Posting of defence document. The target's board should circulate its defence document as soon as possible after the posting of the offer document, and in any event within two weeks.
- DAY 21 First closing date. The offer must be open for a sufficient time to allow the target to circulate its views on the offer, although this does not prevent an offer being declared unconditional by an earlier date. The Office of Fair Trading normally undertakes to indicate by this date whether a reference should be made to the Competition Commission.
- DAY 22 The bidder may not, with certain exceptions, acquire interests in shares before this date which would bring its holding to 30 per cent or more of the voting rights of the target company (except if acquired from a single shareholder).
- DAY 21 - 46 Period during which a revised offer may be posted.
- DAY 35 First possible day for an offer to close after DAY 21 - if an offer has been declared or becomes unconditional as to acceptances, it must remain open for acceptance for at least 14 days after it would otherwise have expired.
- DAY 39 No material information may be announced after DAY 39. This allows the bidder one week in which to consider any new information before DAY 46.
- DAY 42 Once an offer has been declared unconditional as to acceptances, a bidder has 21 days in which to satisfy or waive any offer conditions which remain outstanding. An offer that is declared unconditional as to acceptances on DAY 21 must therefore be declared wholly unconditional by DAY 42. Shareholders who have accepted, may withdraw their acceptances after 21 days from the first closing date of the initial offer (ie, usually after DAY 42) if the offer has not been declared unconditional as to acceptances.
- DAY 46 An offer must be kept open for at least 14 days from the date of posting of an offer or revised offer. Since DAY 60 is the last day on which an offer or its revision can be declared unconditional as to acceptances, DAY 46 is the last opportunity for the posting of a revised offer.
- Furthermore, the bidder cannot after DAY 46 buy shares to take its shareholding in the target over 30 per cent.
- DAY 60 If the offer has not achieved the minimum number of acceptances stipulated in its terms (at least 50 per cent), it will lapse. The bidder (except in certain specific circumstances) may not make a further offer for a period of 12 months from that date nor, if it already owns (or would own as a result of such acquisition) 30 per cent or more of the target shares, may not acquire any further shares in the target company in the 12 months from that date.
- DAY 81 Last day by which any other conditions must be satisfied, on an offer declared unconditional as to acceptances.

Offer document information

In order to enable shareholders to evaluate fairly the proposals and arguments in the documents produced in a takeover, the Code provides:

- shareholders must be given sufficient information and advice to enable them to reach a properly informed decision and must have sufficient time to do so and no relevant information should be withheld from them, and
- any document or advertisement addressed to shareholders containing information or advice from a bidder or the board of the target company or their respective advisers must, as is the case with a prospectus, be prepared with the highest standards of care and accuracy.

Responsibility

The directors of the bidder must accept responsibility for the information in all documents sent to shareholders (save for the information relating to the target and its directors, for which the target directors will take responsibility) and to state that, to the best of their knowledge and belief (having taken all reasonable care to ensure that such is the case), the information contained in the document is in accordance with the facts and does not omit anything likely to affect the import of such information.

In order to assist the directors, a formal verification process (which consists of checking the facts and the bases and assumptions for statements of opinion or belief contained in the documentation) is undertaken prior to the public release of the document. Sometimes, the bidder board may appoint a committee to which to delegate the detailed consideration of this matter. All the directors, however, must believe that the committee is competent to do the task before it and must make the personal disclosures required of them by the Code. The delegation to a committee does not affect a director's responsibility.

The standards of care and responsibility placed by the Code on parties connected with such documents are strengthened by the provisions of FSMA which makes it an offence to make a misleading or false statement, or to conceal material facts, for the purpose of inducing another person to enter into, or to refrain from entering into, an "investment agreement". This is defined so as to include acceptance of an offer. Such behaviour would also constitute market abuse.

The offer document

The offer document contains, amongst other things, the commercial arguments for the offer - the price, the commercial logic and the merits of the bidder's management. The offer document also contains the terms of the offer, information regarding the consideration, the procedure and timetable for acceptance, the circumstances in which the offer can be revised, the timetable and the rights of withdrawal.

The Code requires information to be included regarding, amongst other things:

- the bidder's intentions towards the business of the target and its employees
- financial and other information on the bidder and the target
- details of the other financing arrangements, and
- shareholdings and dealings in the last 12 months of the bidder and its directors in the target shares and, in the case of a securities exchange, the bidder's shares.

The amount of information required under the Code varies depending on whether or not the offer is a securities exchange offer or a cash offer.

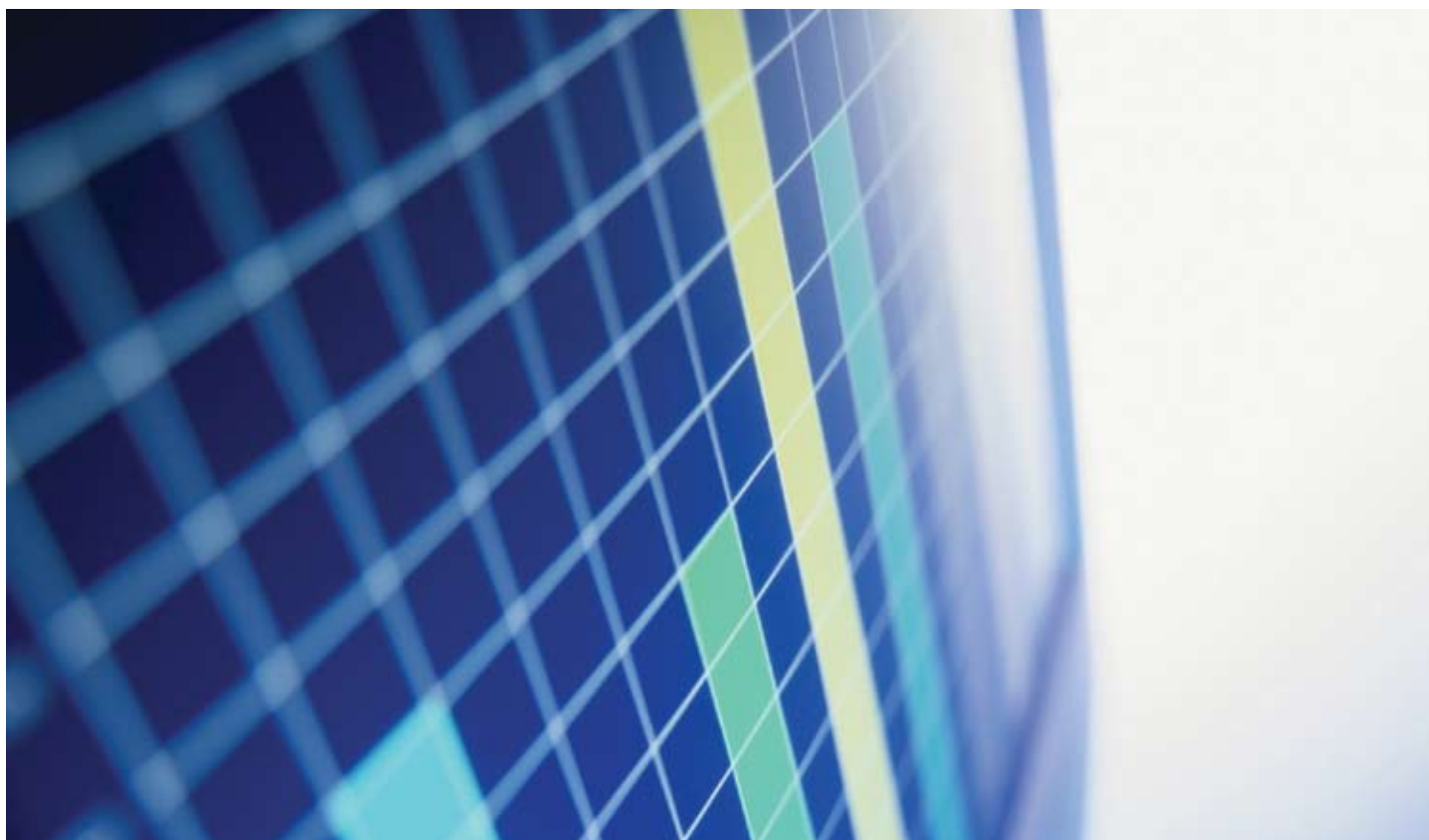
In addition, in the case of a securities exchange offer, the offer of securities to the shareholders of the target is likely to constitute an offer of transferable securities to the public. This will not require an approved prospectus to be published, provided that a document is available which contains information regarded by the Financial Services Authority as equivalent to a prospectus. However, the Financial Services Authority's position is that in order for it to determine that the document is equivalent to a prospectus, it applies a full vetting process to the document. This has timing and costs implications for bidders.

The defence document

The Code requires the board of the target company to circulate to its shareholders its views on an offer and to make known the advice of its independent advisers. The target directors must also provide information on shareholdings and dealings by directors and connected parties. In the case of a recommended offer, this information will be included in the offer document. In a hostile bid, this information will form a part of a separate defence document (which must be posted within 14 days of the offer document).

Further documents

If the bidder is listed on the Official List, the requirements of the Listing Rules may in certain circumstances necessitate the sending of a circular to its shareholders about the proposed acquisition and, where shares are being offered as consideration and the exemption from the need to publish a prospectus is being relied upon, may require the issue of an equivalent document.



Minority shareholder "squeeze out"

The CA06 contains provisions which enable a bidder to acquire compulsorily the shares held by shareholders of the target who do not accept the offer. Where the bidder has received acceptances in respect of 90 per cent or more of the shares to which the offer relates, it may, subject to any court order to the contrary, acquire the outstanding shares on the same terms set out in the offer. It can also, in these circumstances, be forced by the minority shareholders themselves to acquire their outstanding shares.

A minority shareholder is entitled to apply to the court to resist being "squeezed out". The court may order either that the compulsory acquisition may not be effected or that the shares are acquired on different terms from those available under the offer. The non-assenting minority shareholder must show "special circumstances" which would make the acquisition of these shares unfair. This is not easy, as the court will be greatly influenced by the fact that holders of 90 per cent of the shares have accepted the offer.

The Companies (Acquisition of Own Shares) (Treasury Shares) Regulations 2003 enable companies to buy back their own shares and to hold these 'on treasury' for re-sale at some future date. Such shares, known as treasury shares, remain "issued" and can be transferred, for example, to an employee share scheme. For the purposes of calculating whether the requisite 90 per cent threshold has been reached, treasury shares are ignored.



Financing the offer

Certainty of funds

In all public offers, a bidder must have sufficient resources to satisfy full acceptance of the offer. Accordingly, the terms of all financing of the offer must ensure that the funds are certain and available at the appropriate times - in other words, to satisfy payment of the offer consideration when it becomes due under the offer and the sums which will become due to minority shareholders under the squeeze out procedures. In practice, this means that any loan agreement must have no unsatisfied conditions precedent to draw down in the period following the announcement of the offer, save that the only events which will entitle the debt provider to withdraw its finance (during the "certain funds" period) will relate to the solvency of the bidder and the failure to satisfy the conditions on which the bid is made.

Debt providers will invariably want to regulate the conduct of an offer and to restrict a bidder's ability to declare its offer unconditional unless and until the requisite 90 per cent acceptance level has been reached.

If a debt provider proposes to syndicate its loan to the bidder to persons who are also shareholders in the target company, the Panel must be consulted to ensure that there is no breach of the rules concerning favourable conditions being offered to some but not all shareholders.

Re-registration as a private company and financial assistance

A debt provider will commonly want its loan to the bidder to be secured on the assets of the target and its subsidiaries. This will amount to the giving of financial assistance by the target group and as such will be unlawful unless certain statutory procedural requirements (commonly referred to as the "whitewash procedure") have been complied with. The law relating to financial assistance would also prohibit the target (or any subsidiary) providing guarantees or indemnities to the debt provider unless the whitewash procedure is first complied with.

Whitewashing cannot take place until after an offer has been declared unconditional and the target and those of its subsidiaries which are public companies have first been re-registered as private limited companies.

Accordingly, in contrast to a private company acquisition, where the lender will take security over all the assets at completion, the provision of debt financing in a public company takeover will often take on a three stage approach:

- (1) when the bidder's press announcement is released, announcing a firm intention to make the offer under rule 2.5 of the Code, the lending bank will take a charge over the undertaking and assets of the bidder, including any shares acquired in the target company as a result of acceptances of the offer
- (2) when the offer is declared or becomes unconditional in all respects, the target and its subsidiaries can grant charges to a lending bank to secure any new working capital advances made by the lending bank to the target and its subsidiaries, and
- (3) once the target and any of its public company subsidiaries have been re-registered as private limited companies and the whitewash procedure has been complied with, further charges/cross guarantees can be granted by the target and its subsidiaries to secure the acquisition loan facilities which were provided to the bidder to finance the bid.

Re-registration as a private company requires the passing of a special resolution of a company's shareholders. Shareholders numbering 50 or more or holding not less than 5 per cent of the issued share capital or of any class of shares, who do not consent to or vote in favour of the resolution - for example, target shareholders who have not yet accepted the offer (even though it has become unconditional) - can apply to the court to have any re-registration resolution cancelled. Shareholders who do not object within a 28 day period become barred from objecting thereafter.

The whitewash requirements, which are generally postponed until after this 28 day period unless acceptances of the offer have exceeded 95 per cent and there are less than 50 non-asserting shareholders, are as follows:

- the companies giving financial assistance must each have "net assets"
- net assets must not be reduced by the financial assistance, unless such company has distributable profits of an amount at least equal to such reduction
- the directors of the company giving the financial assistance (and its holding company, if it is a subsidiary of the company whose shares are acquired) must swear a statutory declaration that, in their opinion, the company giving the financial assistance will be able to pay its debts as they fall due in the 12 months following the giving of the financial assistance
- a report from the company's auditors, confirming that they have enquired into the state of affairs of the company concerned and that they are not aware of anything to indicate that the directors' opinion is unreasonable in all the circumstances, must be annexed to the directors' statutory declaration, and
- the ultimate holding company and any of its subsidiaries which are not wholly owned, must pass a special resolution approving the financial assistance. Most lenders, however, usually require all companies giving financial assistance to pass special resolutions.

Pursuant to the CA06, the whitewash requirements for a private company will be repealed from 1 October 2008.

Leveraged/management buy outs ("MBOs")

The management of public companies is sometimes asked to participate financially in bids for their companies - usually in bids financed by private equity houses, which are keen to ensure continuity of management going forward. In these transactions, the bidding vehicle is usually a newly-incorporated company in which management and the private equity house have shares. Loans provided by third party lenders usually form the majority of the acquisition finance required.

Conflict of interest - Independent committee

There is an obvious inherent conflict of interest in any proposed takeover where some or all of the directors of the bidding vehicle are also directors of the target company.

- As a result, where a public to private transaction involving an MBO is contemplated, it is important that the target board creates an independent committee as soon as possible, whose role will be to consider the proposals made by the management team; to decide whether, in principle, it is in the company's interests for the MBO team to formulate an offer to be put to shareholders and to advise shareholders on whether or not to accept the offer.
- The independent committee should comprise only those directors of the target company who are unconnected with, and independent of, the MBO team (or any competing bidder), in other words, no member of the independent committee should have any continuing role (whether executive or non-executive) in either the bidder or the target company, in the event of the offer being successful.
- Where all of the directors of the target have an ongoing connection with the bidder and/or target after completion, the target company's financial advisers are usually permitted to take on the role of the independent committee and advise the shareholders on the merits of the particular offer.

The Code

The Code contains special rules to protect shareholders where the target's management is associated with the bidder.

- The target board must obtain competent independent advice on an offer and the substance of such advice must be made known to its shareholders.
- In an MBO, it is particularly important that the independence of the adviser is beyond question. If the existing financial adviser of the target company has had an especially close relationship with any member of the MBO team, the target should consider the appointment of a new financial adviser to advise the independent committee on the merits of the offer and the Panel should be consulted in such cases. The Code makes it clear that the responsibility borne by the adviser is considerable and, therefore, the target board should appoint an independent adviser as soon as possible after it becomes aware of the possibility that an offer may be made.
- As a general rule, no bidder, or any persons acting in concert with it, may make (except with the consent of the Panel) any arrangement with shareholders to deal in shares of a target company or enter into arrangements which involve acceptance of an offer, if there are favourable conditions attached which are not being extended to all shareholders. If the management team are taking an equity interest in the bidding company, even if only in exchange for some or all of their shares in the target, this arrangement should ordinarily be offered to all shareholders, so that all shareholders are treated equally. The Panel will need to be consulted and its consent obtained if a share alternative is not to be extended to all shareholders. The Panel will invariably require, as a condition of its consent, that the arrangement be approved at a general meeting of the target's shareholders, at which only independent shareholders can vote and at which a poll must be taken.
- If any special deals are to be extended beyond the members of the MBO team to their immediate family, the Panel should be consulted at an early stage. The Panel will not usually consent to such an extension unless it can be justified in some way, such as part of a tax planning exercise.
- No member of an MBO team would ordinarily be able to deal in shares of the target when there is reason to suppose that an approach or an offer may be made by a company connected with them up to the time of the announcement of the approach or offer (or termination of discussions).
- The MBO team may commonly be deemed to be acting in concert with the bidder and its other shareholders and should, therefore, be careful that their aggregate shareholdings in the target do not exceed 30 per cent, thereby triggering a mandatory offer for the target. Consideration should be given to the entering into of "standstill agreements" (whereby the parties agree not to purchase shares, save in certain circumstances) between parties acting in concert. "Standstill" provisions may also be included in the investment agreement between the private equity investor and management team.

Due diligence

Disclosure of information on the target in an MBO gives rise to some specific issues under the Code:

- Management will be in possession of confidential price-sensitive information about the business affairs of the target. Non-public information concerning the target company should only be made available to the equity or debt provider (or other external parties) with the prior consent of the independent directors. Failure to obtain such authorisation could result in a breach of confidentiality and potential civil liability for the misuse of the information.

- As any information which is given to potential providers of finance (whether equity or debt) to the bidder must also be given to another competing bidder or bona fide potential bidder under the Code, the independent directors will want to keep a tight control on the information which the management team can provide to its debt and equity providers, normally by way of undertaking from the relevant parties, preventing access to and disclosure of confidential information without the consent of the independent directors.

General issues

- An MBO will obviously involve a considerable amount of management's time and will most likely cause them to be in breach of certain of the contractual provisions in their employment contracts, such as an obligation to devote their "full time and attention" to their employer's business; any restrictions on being involved in another business or company; and confidentiality provisions. Each member of the management team should obtain the appropriate releases of any relevant restrictions.
- Private equity houses are likely to require warranties from an MBO management team in relation to the target's business and affairs. This raises difficult issues and is a subject that needs to be addressed early. The principal reason for seeking such warranties in a public to private transaction is to ensure proper disclosure of information, rather than providing a means of economic redress for the private equity house. Obviously, no warranties will be given by the selling shareholders.

ISC Guidelines on public to private deals

Difficulty can sometimes arise with leveraged MBOs in convincing target shareholders to accept an offer, as they may feel that if the management sees value in the business, it should deliver this value to existing shareholders.

It may be helpful to bear in mind some of the guidelines on management buyouts of listed companies that have been issued by the Institutional Shareholders' Committee:

- An MBO proposal is unlikely to be favourably received unless it is made by the executives of a target company on the board of which there is, and has been for some time, a strong independent non-executive presence.
- In the event of an MBO proposal, it would not be appropriate for the bidder to employ as advisers those who have previously been employed as such by the target company unless independent non-executive directors advise that the interests of shareholders would not be adversely affected by such an arrangement between the bidder and those advisers.
- It is most unlikely that MBO proposals would receive a sympathetic response unless they were supported and recommended by the independent non-executive directors of the target company.
- Ideally, the board of the target company should appoint a separate committee consisting wholly or mainly of non-executive directors with direct access to independent advisers. Independent advisers should have access to all information necessary to enable them to give a fully informed opinion as to the merits of the offer. This independent committee should be responsible for a separate statement to shareholders, giving the views of both itself and of the independent advisers on the bid. Bidders should not have access to the target company's usual professional advisers, since this would aggravate the conflict of interest.



UK and EU merger control

United Kingdom

The UK merger regime involves a preliminary investigation by the OFT. If the OFT makes a reference to the Competition Commission, the Competition Commission will then undertake an in-depth investigation. In a major change from the previous regime, Ministers are involved in the decision-making process only in exceptional circumstances.

Jurisdiction

Transactions can be investigated where:

- two or more enterprises cease to be distinct, and
- either the turnover or the share of supply test out below is satisfied.

Two enterprises cease to be distinct where they are brought under common control or ownership. Control is not limited to voting control, but extends to material influence, which may be acquired with a stake of as little as 10 per cent. An increase in the level of control may also be caught.

Share of supply test

The test will be met where the enterprises participating in the transaction are engaged in supplying or acquiring goods or services of the same description and between them supply or acquire at least 25 per cent of those goods or services in the UK or a substantial part of it.

The merger must therefore create or enhance a share of 25 per cent or more of the goods or services on which the parties' activities overlap.

This test is considerably wider than a conventional market share test.

Turnover test

This test is met where the UK turnover of the enterprise being acquired exceeds £70m.

Unless there have been significant changes since the accounts were prepared, the OFT will generally accept the turnover shown in the accounts of the last business year. Where only part of a business is acquired, it will be necessary to provide evidence of its turnover to the OFT.

Merger clearance

The UK merger regime is voluntary in the sense that there is no legal obligation to notify a transaction. However, it is not safe to assume that the OFT will not find out about a merger which satisfies the jurisdictional tests. The OFT has the power to prevent parties from implementing a merger pending clearance from the OFT or Competition Commission. There is also the power to order divestment of a completed merger.

The OFT must (subject to certain limited exceptions) refer a merger to the Competition Commission if it believes that it is or may be the case that a relevant merger situation (ie, satisfying the jurisdictional thresholds) will result, and that it may be expected to result in a substantial lessening of competition ("SLC") within a UK market.

The courts have declined to specify exactly where on the scale of meaning implied by the words "may be the case" the threshold for reference should fall. It clearly excludes the purely fanciful.



It is not obligatory to seek clearance, but it is usual to do so, particularly where the share of supply test is satisfied and competition issues exist. Where clearance has not been sought, a reference may be made to the Competition Commission up to four months after the transaction has been made public.

If a notification is made, the OFT will expect to see information memoranda, business plans, board papers and reports prepared for the purposes of assessing the deal. Great care should therefore be taken, even at an early stage, to avoid making claims or predictions about the parties' combined market position, for example, that will be hard to defend before the authorities. The same principle applies in EC filings, discussed below.

There are three ways of obtaining merger clearance without a Competition Commission reference:

- by obtaining informal advice before any public announcement (but this may not be available or reliable if the case raises sensitive competition issues and third party views cannot be sought). A response can be expected within about 10 working days
- by making an informal application for clearance. An application for informal advice may be converted into an application for clearance. There is no binding timetable for this procedure, but the OFT aims to issue a decision within about 40 working days, or
- by applying under the formal merger notice procedure, once a public announcement has been made. The official merger notice form must be used. The OFT must respond within 20 working days, subject to extension by up to 10 working days. This procedure offers the greatest degree of certainty but is not generally favoured.

The periods for considering a merger start when a fully completed submission is received by the OFT.

In appropriate cases undertakings may be accepted in lieu of a reference. Time limits are suspended while undertakings are negotiated.

A fee, varying according to the UK turnover of the enterprise acquired, is payable on clearance or reference under the informal procedure, and on application under the statutory procedure. The maximum fee is currently £45,000.

Competition Commission

If a merger is referred to the Competition Commission, it must decide whether the merger can be expected to result in an SLC. The Competition Commission must usually report within 24 weeks, with a possible extension by a further eight weeks.

In reaching its decision whether there is an SLC the Competition Commission must decide whether an SLC is more likely than not to occur. A mere possibility that there may be an SLC will not be enough for the Competition Commission to rule against the transaction.

If the Competition Commission recommends against a merger, it may make an appropriate order, including a divestment order, and can also accept undertakings in lieu of an order.

EC Introduction

The EC Merger Regulation (Regulation 139/2004) (the "ECMR") provides for the mandatory pre-notification to the European Commission of all mergers with a Community dimension, with very limited exceptions. The Commission will assess the compatibility of such mergers with the common market and, depending on that assessment, will either approve them (with or without conditions) or prohibit them. The ECMR, a revision of the 1989 original, introduced a new substantive test and procedures.

Turnover thresholds

A merger will have a Community dimension and will, therefore, be subject to notification and examination by the Commission in accordance with the ECMR if:

- (a) the combined aggregate world-wide group turnover of all the parties is more than €5bn (£3.8bn)
- (b) the aggregate Community-wide turnover of each of at least two of the parties is more than €250m (£187m), and
- (c) each party obtains no more than two-thirds of its aggregate Community-wide turnover within the same one Member State (ie, mergers which primarily concern a single Member State fall outside the Regulation).

The ECMR also applies where:

- (a) the combined aggregate world-wide group turnover of all the parties is more than €2.5bn (£1.9bn), and

- (b) in each of at least three Member States the combined aggregate group turnover of all the parties is more than €100m (£75m), and
- (c) in each of at least three Member States included for the purposes of (b), the aggregate turnover of each of at least two of the parties is more than €25m (£18.8m), and
- (d) the aggregate Community-wide turnover of each of at least two of the parties is more than €100m (£75m), and
- (e) each party obtains no more than two-thirds of its aggregate Community-wide turnover within the same one Member State.

In cases falling below these thresholds, where it would otherwise be necessary to notify in three or more national jurisdictions, the parties may request the Commission to take over the case from the national authorities.

If no Member State concerned opposes the application, the Commission will have exclusive jurisdiction throughout the EEA. If any Member State objects, the case will not be referred. The opposite scenario is also possible.

In the case of sales of part of a business (for example, a division or subsidiary), the vendor's turnover to be taken into account is only the turnover of the part of the business sold. There are special rules for calculating the turnover of banks and other financial institutions.

Timing and procedure

Notification may be made on the basis of a "good faith intention" to enter into an agreement. The key timing requirement is not to implement the transaction before receiving clearance. The filing itself requires the compilation and detailed analysis of large volumes of information, and several weeks should therefore usually be allowed for preparation of the filing.

The Commission must examine every merger notified to it within strict time limits:

- Phase 1 lasts for 25 working days, but is extended to 35 working days where the parties offer remedies in lieu of Phase 2
- Phase 2 normally lasts for 90 working days, but is automatically extended to 105 working days if the parties offer remedies on or after working day 55 following the start of Phase 2, and
- Phase 2 may be further extended by up to 20 working days if either the parties make a request to that effect within 15 working days of the start of Phase 2, or the Commission proposes an extension and the parties consent.

Substantive test

The Commission is required to determine whether or not a merger falls within the scope of the ECMR and, if so, whether or not it raises serious doubts as to its compatibility with the common market. If the Commission finds that a notified merger does raise such doubts, it must take the step of opening proceedings, starting Phase 2.

The Commission will prohibit a merger if it will "significantly impede effective competition, in the common market or a substantial part of it, in particular as a result of the creation or strengthening of a dominant position." This may be the case either where the merger creates or strengthens a leading player in the market, or where it otherwise reduces the level of competition in the market. The Commission may be prepared to accept undertakings, for example to divest part of the acquired business, in lieu of the start of Phase 2 proceedings or a prohibition decision.

The Commission may impose fines for failure to notify a notifiable merger in due time, supplying incorrect or misleading information in a notification or failure to comply with undertakings given to the Commission.

Mergers which have a Community dimension, and which must therefore be notified to the Commission under the ECMR, fall in principle within the exclusive competence of the ECMR. A merger, once approved by the Commission under the ECMR, may not generally be prohibited or subjected to conditions by the merger control authorities of Member States. However, there are exceptions to this rule.

Appendix

General principles of the Code

The general principles under the Code are as follows:

1. All holders of the securities of an offeree company of the same class must be afforded equivalent treatment; moreover, if a person acquires control of a company, the other holders of securities must be protected.
2. The holders of the securities of an offeree company must have sufficient time and information to enable them to reach a properly informed decision on the bid; where it advises the holders of securities, the board of the offeree company must give its views on the effects of implementation of the bid on employment, conditions of employment and the locations of the company's places of business.
3. The board of an offeree company must act in the interests of the company as a whole and must not deny the holders of securities the opportunity to decide on the merits of the bid.
4. False markets must not be created in the securities of the offeree company, of the offeror company or of any company concerned by the bid in such a way that the rise or fall of the prices of the securities becomes artificial and the normal functioning of the markets is distorted.
5. An offeror must announce a bid only after ensuring that he/she can fulfil in full any cash consideration, if such is offered, and after taking all reasonable measures to secure the implementation of any other type of consideration.
6. An offeree company must not be hindered in the conduct of its affairs for longer than is reasonable by a bid for its securities.



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