SLAUGHTER AND MAY

Proposed changes to the Takeover Code and a new Practice Statement

July 2017

The Panel has published a consultation paper (PCP 2017/1) in relation to asset sales by a target company in competition with an offer. This briefing sets out the proposed amendments to the Takeover Code, some of which have broader application than the immediate subject matter of the PCP suggests. The Panel has also published a new Practice Statement in relation to the conduct of strategic reviews and formal sale processes.

PCP 2017/1: Asset sales in competition with an offer and other matters

On 12 July the Panel published PCP 2017/1 in order to seek views on a number of proposed amendments to the Takeover Code. Responses to the consultation are requested by 22 September.

The immediate concerns addressed by the PCP have arisen after two instances in 2016 where a target had received a takeover offer but decided that better value could be delivered to shareholders by selling all of its assets to a third party, and then returning the proceeds to shareholders[1]. However, the proposed changes have broader application than may appear at first glance and may catch both bidders and target companies unawares if they are seeking to take certain actions following the end of an offer period.

Among other things, the proposed rule changes:

- would restrict the ability of a bidder which has previously made an offer for a target to purchase, or agree to purchase, significant assets from the target for a certain period following their offer being withdrawn or lapsing;
- would require bidders to expressly specify the circumstances in which they may set aside a "no intention to bid" (Rule 2.8) statement (thus limiting their ability to make a new offer if they fail to do so); and
- may result in further reporting and disclosure obligations on a target where it is proposing to take certain action that falls within Rule 21.1 (frustrating action) during the course of an offer,

[1] HarbourVest Structured Solutions III LP offer for SVG Capital plc, and Constellation Software Inc. offer for Bond International Software plc.

including a requirement to send a circular to shareholders to inform them of a proposed action even where the action will not take place unless and until the offer lapses.

Preventing an offeror from circumventing the Code by purchasing significant assets of the target

The Panel is concerned that bidders that have announced an offer can circumvent the following provisions of the Code by seeking to purchase the assets, rather than the shares, of a target:

- Rule 2.8 (statements of intention not to make an offer): a bidder that makes a Rule 2.8 statement is restricted for a period of six months from announcing a new offer or possible offer for the target company, unless (broadly) the target board consents or a third party announces an offer for the target.

- Rule 35.1 (delay of 12 months): where the bidder's offer has been withdrawn or lapsed, the same restrictions apply for a period of 12 months, unless the Panel consents. The Panel will not normally agree to lift the restrictions for the first three months where the bidder was prevented from revising or extending its previous offer as a result of a "no extension statement" or "no increase statement".

- Rule 12.2 (competition reference periods): where a bidder's offer is the subject of Phase 2 CMA or European Commission proceedings, the same restrictions apply during the competition reference period.

The Panel is therefore proposing to add a further restriction to each of these rules to prevent a bidder from purchasing, agreeing to purchase, or making any statement about possibly purchasing the assets of the target during those periods.

This restriction will apply to any purchase of assets which are "significant" in relation to the target. For this purpose, the Panel will apply the same criteria (consideration, assets and profits) that it uses when determining whether a proposed disposal or acquisition by a target company is of a "material amount" for the purposes of Rule 21 (frustrating action). Relative values of 50% or more will normally be regarded as significant.

Asset sales and other frustrating action subject to Rule 21.1

Under the Panel's proposals, where a target is subject to an offer or possible offer and is proposing to take action which would be restricted under Rule 21.1 (frustrating action) (for example, where the target proposes to issue any shares, dispose of assets of a material amount, or enter into contracts other than in the ordinary course of business):

- if the target is seeking shareholder approval at a general meeting, the board must obtain competent independent advice on whether the terms of the proposed action are fair and reasonable;

- the Panel must be consulted regarding the date on which the general meeting will be held;

- (although this was always the case in practice) it is now expressly stated that the approval of target shareholders will not be required if the proposed action is conditional on the offer being withdrawn or lapsing; and

- the target board must send a circular to shareholders containing certain specified information (even in circumstances where shareholder approval is not required as the proposed action is conditional on the offer being withdrawn or lapsing) as soon as practicable after the announcement of the proposed action.

Furthermore, the target will be permitted to pay an inducement fee to the counterparty of the proposed transaction, subject to a *de minimis* limit of 1% of the value of the transaction.

Sales of all or substantially all of the target's assets in competition with an offer

Where the target is proposing to sell its assets and return value to shareholders as a competing proposal to an offer or possible offer (as was the case in HarbourVest's bid for SVG Capital which was subsequently structured as an asset sale of SVG's portfolio of assets), shareholders will inevitably measure the two transactions against each other. The Panel is therefore proposing that such competing transactions should be addressed in the Code:

- If the target states the amount it expects to return to shareholders, this will be treated as a "quantified financial benefits statement" and will have to be reported on by the target's reporting accountants and financial adviser.

- The purchaser of the assets will be prevented from buying target shares at a price greater than the stated amount per share expected to be returned to shareholders.

- Due diligence information given by the target to the potential asset purchaser must be given to the other bidder on request in cases where discussions between the asset purchaser and the target have been announced or where the bidder has been authoritatively informed of such discussions, unless the target was already in discussions with the asset purchaser before an offer has been made or the target's board had reason to believe that a bona fide offer was imminent.

Other matters in PCP 2017/1

In addition, the Panel is proposing certain other amendments:

- The circumstances in which a party making a Rule 2.8 statement (no intention to make an offer) may subsequently set aside that statement before the end of the six month period are currently set out in the Notes to Rule 2.8. The Panel intends to change this so that the circumstances will have to be set out in the statement itself. This will avoid any market confusion and allow parties to make a "hard" statement if they wish to do so (i.e. that it will not be set aside in any circumstances). However, as these reservations are no longer "hardwired" in the Code, bidders need to ensure that they do expressly reserve their rights in the relevant circumstances, otherwise they would be unable to make a new offer even if, for example, a third party announces an offer for the target during that period.

- The restrictions on the use of social media in Rule 20.4 are to be relaxed, so that parties to an offer may use social media to communicate information about themselves. The restrictions will still apply in relation to information relating to the offer, which must still be published via an RIS and the company's website. Moreover, the Panel is proposing to make it explicitly clear in the Code that it regards financial advisers as responsible to the Panel for guiding their clients with regard to information published via social media during the offer in the same way as for information published by other means.

New Practice Statement 31

On 7 July the Panel published a new Practice Statement No 31. It describes the way in which the Executive applies the Code where a company wishes to announce a strategic review of the business which may lead to an offer for the company or conduct a "formal sale process". There has been an increase in companies making such announcements in recent years, with 11 companies announcing that they are conducting either a strategic review or a "formal sale process" in the year ended 31 March 2016 and 16 in the year ended 31 March 2015, compared with only 6 in the year ended on 31 March 2014 (and 7 in the year ended 31 March 2013).

The Practice Statement largely consolidates Practice Statements 3 (Controlled Auctions) and 6 (Strategic review announcements) which have accordingly been withdrawn. Certain minor changes have been made, which confirm existing Panel views:

- If the company is not in talks with any potential offeror and is not in receipt of any approach with regard to a possible offer when it makes the strategic review announcement, this should be stated in the announcement.

- Following the announcement of a formal sale process, any information passed to any potential offeror participating in the process must, on request, be passed to a bona fide potential competing offeror, even if that party is not participating in the formal sale process.