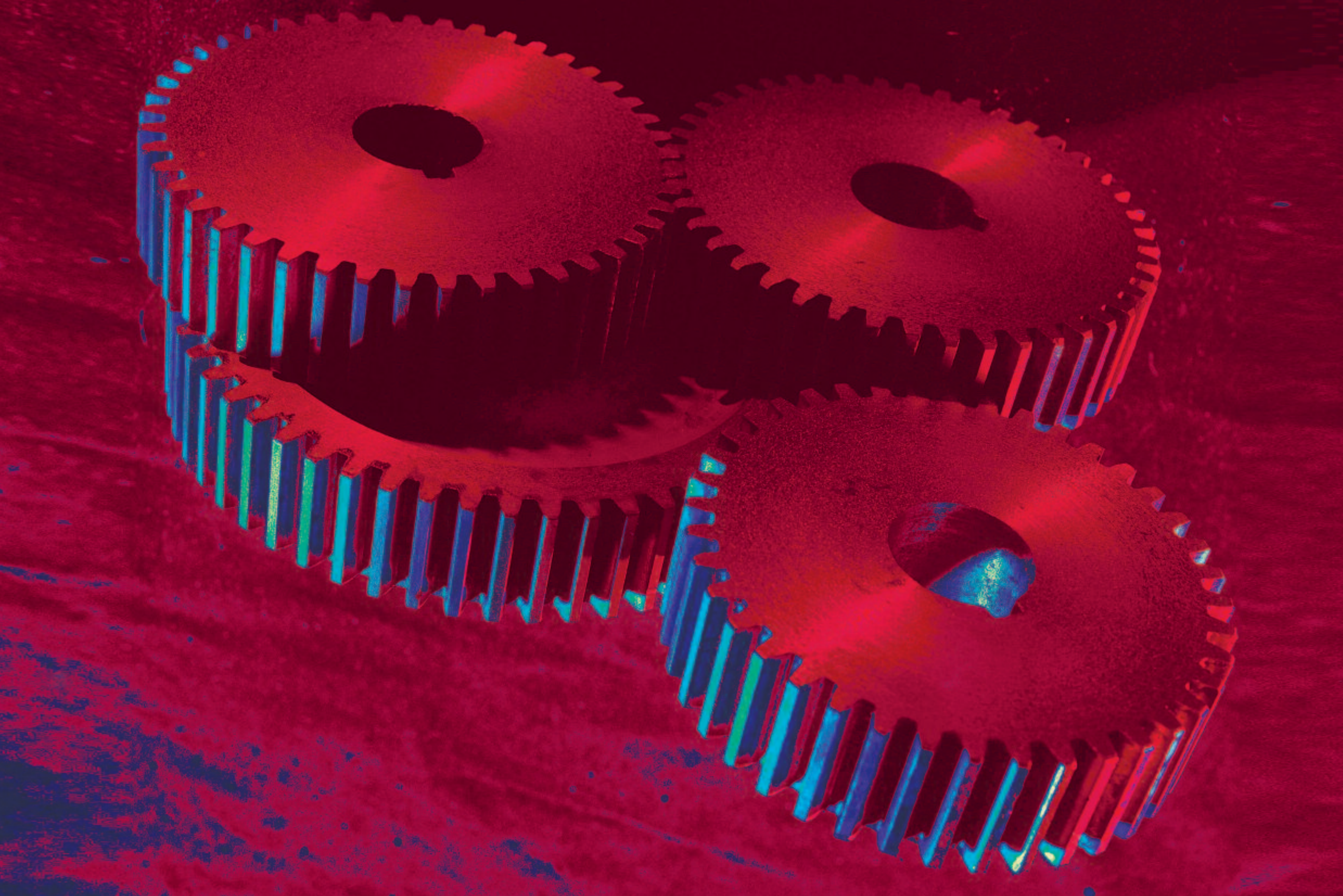

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A Guide to Takeovers in the UK

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Foreword

This guide provides an overview of takeovers of public companies (whether listed or otherwise) in the UK, including acquiring a stake in a UK public company and launching (or defending) a formal takeover bid. It considers, from both a legal and regulatory perspective, the various stages of a takeover from planning a bid through to achieving control of the target. It offers clear explanations on key issues including pre-bid planning (Section 2), implementing a takeover by scheme of arrangement (Section 3), competition clearances (Section 4) and stakebuilding before an offer (Section 5). The guide covers the making of an offer (Section 7), defence tactics on a hostile bid (Section 8), events following a successful offer and consequences of an unsuccessful offer (Sections 8 and 9 respectively) and issues arising on MBOs and similar transactions (Section 11). It does not, however, consider any tax or accounting implications of a takeover or the impact of securities laws of other jurisdictions where the target has shareholders resident overseas.

Definitions of words and expressions used are contained in the Glossary at the end of the guide.

This guide does not purport to be comprehensive or to render legal advice. The position stated is at 1 May 2008.

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List of Tables

Summary of the General Principles of the Code 3
Implications of acting in concert with a bidder 16
Scheme timeline 22
Summary of legal and regulatory implications of interests in UK companies at various percentage levels 42
Offer timeline 49
Section 397 Financial Services and Markets Act 2000 51
Comparative table of principal documents involved in recommended and hostile offers 55
Bid document content requirements 56
Defence document content requirements 69
Glossary 86

contents

1.	Overview of regulatory framework	1
2.	Pre-bid planning	6
3.	Schemes of arrangement	17
4.	Competition	23
5.	Acquiring a strategic stake before a bid	32
6.	Acquiring control	40
7.	Making a bid	47
8.	The defence	65
9.	Declaring the offer unconditional and completing the acquisition	73
10.	Consequences of an unsuccessful bid	78
11.	MBOs and similar transactions	81
	Glossary	86
	Index	87

1. Overview of regulatory framework

1.1 Regulation of takeovers 2
1.2 Statutory and regulatory provisions affecting takeovers 5
1.3 Pensions legislation 5

1.1 Regulation of takeovers

1.1.1 Regulatory framework

The Takeover Code (Code) provides the main framework regulating the conduct of takeover and merger transactions in the UK. The Code applies to takeovers of companies that have their registered office in the UK, Channel Islands or Isle of Man, and have their securities admitted to a regulated market (for example, the main market for listed securities of the London Stock Exchange or the PLUS listed market) or a stock exchange of the Channel Islands or Isle of Man. It also applies to takeovers of unlisted public companies (including those whose securities are traded on AIM or other unlisted PLUS markets) which are resident in the UK, the Channel Islands and the Isle of Man and takeovers of certain private companies having public company characteristics.

The Code applies to takeover and merger transactions, however they are effected, including by way of a contractual offer, statutory merger or Court-approved scheme of arrangement, as well as other transactions which may effect a change or consolidation of control of the relevant company. The Code is drafted from the perspective of a contractual offer but contains a schemes appendix (Appendix 7 to the Code), which sets out the adaptations which apply on a takeover implemented by scheme. This publication is therefore drafted from the perspective of a contractual offer with commentary as necessary in relation to takeovers implemented by scheme. In recent Code transactions schemes have been used increasingly often; a substantial majority of recent high value bids used a scheme structure. Section 3 describes the scheme process.

1.1.2 Shared jurisdiction

Certain provisions of the Code may apply to other companies in limited circumstances. Where a company is incorporated in another EEA member state and its securities are traded in the UK (or vice versa) the Panel may, in certain circumstances, share jurisdiction over takeovers of such companies with the regulator in the other member state. The shared jurisdiction requirements, which were introduced by the Takeovers Directive, are complex and early consultation with both sets of regulators on relevant transactions is essential.

1.1.3 The Panel

The Code is issued and administered by the Panel on Takeovers and Mergers. The Panel's membership is drawn from the various regulatory and professional bodies involved in the field of takeovers, as well as representatives from British industry. The Code and the Panel operate principally to ensure the fair and equal treatment of shareholders and the orderly conduct of takeovers. The Panel is not concerned with the financial or commercial merits of a takeover or with competition issues.

1.1.4 Panel Executive

The day-to-day functions of the Panel are carried out by the Panel Executive which comprises both permanent and seconded staff. This arrangement ensures both continuity of approach and up-to-date experience of current takeover practices.

1.1.5 Hearings Committee

The Hearings Committee's principal function is to review rulings of the Executive. If a party is dissatisfied with a ruling of the Panel Executive, it can appeal to the Hearings Committee. The appeal is usually heard in the presence of all parties. The Hearings Committee also hears disciplinary proceedings instigated by the Panel Executive when there has been a breach of the Code.

1.1.6 The Takeover Appeal Board

The Takeover Appeal Board is an independent body, which hears appeals against rulings of the Hearings Committee. Any party to a hearing before the Hearings Committee may appeal to the Takeover Appeal Board against a ruling of the Hearings Committee or the chairman of the hearing.

1.1.7 General Principles

The Code consists of 6 General Principles (summarised opposite), which are essentially statements of good commercial practice, and 38 Rules which amplify the General Principles and govern specific aspects of takeover procedure. The fundamental cornerstone of the Code is that all shareholders of the same class should be afforded equivalent treatment (General Principle 1).

Summary of the General Principles of the Code

1. All holders of target securities 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 target securities 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 target board 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 target board must act in the interests of the target as a whole and must not deny the holders of target securities the opportunity to decide on the merits of the bid.

4. False markets must not be created in the securities of the target, the bidder or any other 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. A bidder 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. A target must not be hindered in the conduct of its affairs for longer than is reasonable by a bid for its securities.

1.1.8 Enforcement of the Code

The Panel has a range of statutory enforcement powers and sanctions, including the power to require disclosure to it of documents and information, the ability to require compensation to be paid to target shareholders and the power to seek enforcement orders from the Courts. These statutory enforcement powers and sanctions were introduced as a result of implementation of the Takeovers Directive. The Panel has indicated that it does not expect to exercise these powers, preferring to rely on the sanctions employed since its inception in 1968, including public or private criticism and public censure.

The Financial Services Authority (FSA) supports the functions of the Panel by providing in its Handbook that a regulated firm must not act, or continue to act, for any person in connection with a transaction to which the Code applies if the firm has reasonable grounds for believing that the person in question is not complying or is not likely to comply with the Code (known as the "cold shoulder" principle). This principle reinforces the powers and sanctions of the Panel and, accordingly, anyone seeking to take advantage of the facilities of the securities markets in the UK should comply with the Code and the rulings of the Panel.

Responsibility for compliance with the Code lies with the directors of both the bidder and the target, as well as their professional advisers.

1.1.9 Spirit and letter of the Code

The Code itself acknowledges that it is impracticable to devise rules in sufficient detail to cover all the circumstances which can arise on takeovers. Accordingly, the General Principles and Rules are interpreted by the Panel in accordance with their spirit, as well as their precise wording, to achieve their underlying purpose. The great advantage of the system is its flexibility, as the Rules can be (and frequently are) extended to cover situations not explicitly covered by the Code or can be relaxed in appropriate circumstances.

1.1.10 Timely consultation

The efficiency of the system relies very much on timely consultation with the Panel, both before and during a bid, to enable it to provide expertise and to arbitrate informally. Parties are encouraged to consult the Panel (normally via their advisers) in the event of any doubt as to the interpretation or application of the Code, as only the Panel can give a definitive ruling on the Code. The Panel will also intervene in a bid on its own initiative if it considers that shareholders' interests require it to do so or that a breach of the Code may arise.

1.2 Statutory and regulatory provisions affecting takeovers

A number of statutory and regulatory provisions impact upon the bid process. The Companies Act 2006 provides the statutory underpinning for the Code and the regulatory activities of the Panel. It also contains the procedures for squeeze-out of the minority and the right of the minority to be bought out, in each case once the bidder has acquired 90 per cent. of the target's shares (see section 9.3). The Companies Act 2006 also contains the bid documentation offence (see section 7.3.4) and the statutory procedure applying to schemes of arrangement (see section 3).

This publication briefly covers these statutory provisions and their interaction with the Code. It also refers to the Listing Rules, which will be relevant where either the bidder or the target is a listed company, the Disclosure and Transparency Rules (DTRs), which will be relevant where either company's securities are traded on the London Stock Exchange's main market for listed securities, AIM or PLUS, and the Prospectus Rules, which will be relevant in the context of a securities exchange offer.

1.3 Pensions legislation

Pensions legislation is a further area which may impact upon takeover transactions. The provisions of the Pensions Act 2004 increase the risks associated with the acquisition of companies with defined benefit (final salary) pension schemes. The "moral hazard" provisions allow the Pensions Regulator, in certain circumstances, to impose financial obligations on parties connected or associated with an employer operating a scheme in deficit. It is possible (and in some cases advisable) to seek a clearance statement from the Pensions Regulator in advance of a proposed transaction that, effectively, it would not be reasonable for the Pensions Regulator to use its powers to pursue the parties (or those associated or connected with them) for further pension scheme funding in the context of the transaction. It is not, however, possible to make receipt of such a clearance statement a condition of the offer.

The Pensions Regulator has indicated that parties should consider seeking clearance regardless of the relevant scheme's funding position, where there is a "significant weakening of employer covenant as a result of a corporate transaction". This is likely to be the case in most leveraged deals.

Pension issues must, therefore, be identified, and discussions held with the Pensions Regulator, and/or the trustees of the relevant schemes as appropriate, at an early stage of the transaction.

2. Pre-Bid Planning

2.1	Secrecy and announcement triggers	7
2.2	Management team and professional advisers	9
2.3	Obtaining information on the target	9
2.4	Approaching the target board	10
2.5	Consideration and finance	12
2.6	Bid structure	13
2.7	Acting in concert	15

2.1 Secrecy and announcement triggers

2.1.1 Pre-bid secrecy

The need for secrecy and security before a takeover announcement cannot be over-emphasised. Not only is secrecy a matter of good commercial sense, it is also an important requirement of the Code (Rule 2.1). Before an announcement, the fundamental obligation is that all persons with confidential information concerning an offer or contemplated offer must treat that information as secret and may only pass it to another person on a "need to know" basis and provided that they are made aware of the need for secrecy.

The Panel must be consulted prior to more than six external parties (for example, potential finance providers or the target's pension fund trustees) being approached about an offer or possible offer.

2.1.2 Consequences of rumour, speculation or an untoward share price movement

If the target becomes the subject of any rumour and speculation (whether or not a potential bidder is named) or there is an untoward movement in the target's share price (a movement of 10 per cent above the lowest price since an approach has been made to the target or 5 per cent in a single day is generally regarded as "untoward" for these purposes), the Panel must be consulted - timely consultation with the Panel is essential (see section 1.1.10).

The Panel will then decide whether an announcement is required to be made (see Rule 2.2 and Practice Statement 20). An announcement is usually required where there is evidence of a possible leak - the Panel will take into account all possible factors behind a price rise before reaching its decision. This may mean the possibility of a takeover becoming public earlier than planned. The first announcement confirming a proposed or possible offer will push the target into an offer period, from which time the full range of Code obligations and restrictions will apply.

There are a number of other events which may also require an announcement to be made. All of these are aimed at minimising the risks of a false market in target shares. Members of the bidder and (where relevant) target boards should therefore ensure that a limited number of parties are involved in discussions both to comply with the secrecy requirement of the Code and to avoid the need for a premature announcement.

2.1.3 Responsibility for making announcement

Before a potential bidder has approached the target, the obligation to consult and to make any required announcement rests with the bidder, but following an approach responsibility normally shifts to the target (unless the target unequivocally rejects the bidder's approach). If the parties are unable to reach agreement as to where responsibility lies, the Panel should be consulted.

2.1.4 Holding announcement or possible offer announcement

If an announcement obligation is triggered, a bidder is not normally required to announce a firm intention to make an offer under Rule 2.5 (although, if an announcement is required because an obligation to make a mandatory offer under Rule 9 has arisen, a firm intention announcement will be required - see sections 5.3 and 6.2 on mandatory offers). If the bidder is unwilling or unable to make a firm intention announcement at this stage (for example, because it is still in negotiations with the target board or has not yet arranged firm financing), a brief holding announcement that talks are taking place could be made by the target (without necessarily naming the bidder). If no approach has been made to the target, the bidder could announce that it is considering making an offer.

A brief holding announcement that talks are taking place or that a potential bidder is considering making an offer will normally satisfy the requirement to make an announcement.

2.1.5 Firm intention to make an offer (Rule 2.5 announcement)

The announcement of a firm intention to make an offer should only be made when a bidder has every reason to believe that it can and will continue to be able to implement the offer. Responsibility in this regard is shared with the financial advisers to the bidder (Rule 2.5).

Under the Code, once a Rule 2.5 announcement has been made, the bidder, though not *legally* bound to do so, must (except with the consent of the Panel) proceed with the offer unless the bidder is permitted to invoke a pre-condition to the posting of the offer or would be permitted to invoke a condition to the offer if the offer were in fact to be made (Rule 2.7). The Panel must be consulted in advance if the bidder wishes to make a pre-conditional Rule 2.5 announcement. Rule 2.5 announcements are discussed in more detail in section 7.2.

2.1.6 No intention to bid statement

If the Panel requires a clarificatory announcement from the bidder and the bidder decides not to bid, the announcement will constitute a no intention to bid statement. The statement must be as clear and unambiguous as possible. A person who makes such a statement will generally be prohibited from making an offer for six months (Rule 2.8). The Panel will only permit a change of intention if there is a material change of circumstances or the person expressly reserves the right to make an offer in specified circumstances and those circumstances arise.

2.2 Management team and professional advisers

2.2.1 Appointment of board committee

It is important, particularly in a hostile takeover, that all decisions are taken promptly and that any issues are dealt with swiftly and efficiently. It is therefore advisable for the bidder and the target to appoint a board committee at the outset to deal with urgent issues that arise during the course of the bid.

2.2.2 Collective responsibility of the board

Whilst the Code acknowledges that it is usual for boards of directors to delegate day-to-day conduct of an offer to individual directors or a committee, the Code stresses the collective responsibility of the board during the course of an offer (for example, in relation to responsibility statements in documentation prepared in connection with an offer). The board as a whole is obliged to ensure that proper arrangements are in place to enable it to monitor the conduct of the offer.

2.2.3 Professional advisers

Professional advisers who are familiar with takeovers should be selected. A team should be assembled at an early stage, generally consisting of investment banks (or other financial advisers), brokers, lawyers, accountants and, often, a public relations adviser. The financial adviser to the target (the Rule 3 adviser) will advise the target board in relation to the offer and the substance of its advice must be made known to target shareholders in the bid documentation (see section 8.1.1).

2.3 Obtaining information on the target

2.3.1 Supply of information

The Code permits a target to provide information in confidence to a bona fide potential bidder and in recommended bids a broad range of non-public information is commonly requested by the bidder. However, target companies are sometimes reluctant to comply fully with such requests due to Rule 20.2 which provides that any information which has been supplied to a potential bidder must on request be provided to any other potential competing bidder, even if less welcome. The potential competing bidder is not allowed to request information in general terms but must specify the information required. This does not normally present an obstacle as experienced advisers have widely drawn "shopping-lists" of specific items which are likely to cover all the information that has already been supplied to the preferred suitor.

Rule 20.2 extends to site visits and meetings with target's management in addition to information disclosed by other means. The target and its financial adviser are responsible for ensuring, as far as practicable, that on request less welcome bidders are afforded access to management and site visits equivalent to that which any other bidder has been given.

Detailed records of information provided to a bidder should therefore be maintained by, or on behalf of, a target to enable it to comply with Rule 20.2.

2.3.2 Confidentiality and standstill undertakings

If it is proposed to supply information to a potential bidder, the target usually obtains a suitable confidentiality undertaking first. The agreement entered into with the original potential bidder may contain an undertaking not to buy shares or launch a hostile offer, but the target is not permitted to make the provision of information to other less welcome bidders under Rule 20.2 conditional upon such a standstill undertaking.

2.3.3 Hostile bid

To ensure that its intentions remain confidential, a bidder who does not anticipate a recommendation from the target board usually has to rely only on publicly available information on the target. If the target is a listed company, it will have published information about itself, principally in the form of its annual accounts and interim statements. In accordance with the Disclosure and Transparency Rules, it should also have made announcements of any major new developments in its sphere of activity which may lead to substantial movement in the price of its listed shares. A significant amount of information on a listed target should therefore be publicly available, although this should not be relied upon as being comprehensive.

2.3.4 Dealings in target securities

The Code prohibits persons (other than the bidder) who know about an offer or potential offer from dealing in target securities before the offer or approach has been announced (Rule 4.1). Knowledge of its own possible offer does not prevent the bidder from dealing in target securities.

The bidder may, however, be prevented from dealing by law if any information it has received is price-sensitive information and no exemption or safe harbour is available (see section 5.2). A bidder should therefore be aware that having information about the target may limit pre-bid stakebuilding and detailed advice should be sought before requesting any such information.

2.4 Approaching the target board

2.4.1 Recommended or hostile?

Receiving the recommendation of the target board greatly increases the likelihood of an offer succeeding in the absence of a higher competing bid. If, however, a takeover is “hostile”, there is often a fierce battle with the outcome sometimes unknown until the final day of the bid.

2.4.2 Timing of approach

Although a recommendation is one of the most important factors in securing a successful outcome, it may not always be appropriate to approach the target board until shortly before the bidder is ready to announce its offer. In such circumstances, if the target board decides not to recommend, the bidder can quickly launch a hostile offer without allowing time for the target board to marshal its defences.

2.4.3 Method of approach

The conversation constituting the pre-bid approach should either be made by the bidder directly to the target board or by the bidder's financial adviser to the target's financial adviser. The bidder's financial adviser will advise on how the approach should be made and will ensure that any approach is realistic and credible in order to be taken seriously.

2.4.4 Shareholders' decision

It is a fundamental principle of the Code that the target board must act in the interests of the company as a whole and must not deny shareholders the opportunity to decide on the merits of the bid (General Principle 3). After it has received an approach, the target board is prohibited from taking any action which could frustrate an offer without the consent of target shareholders in general meeting (see sections 8.4 and 8.5).

2.4.5 Subsequent recommendation

A target board which at first rejects an approach may agree subsequently to recommend an offer to shareholders, particularly if the offer price is increased or an element of cash is introduced to what was previously an all-share offer. The decision to recommend may be reached either before the offer is launched (i.e. posting) or during the course of a hostile offer. Where a hostile offer becomes unconditional (i.e. succeeds), the target board will invariably change its advice to shareholders and recommend acceptance on the basis that the alternative is to remain a minority shareholder, usually in a delisted company (see section 9.5).

2.4.6 Bid protection measures

It is common in the UK for target companies to agree to pay a "break fee" to a potential bidder to provide an inducement to the bidder to make its offer. The triggers for payment of such a break fee vary, but break fees will often be payable by a target in the event that any competitive bid for the target is successful or the target board withdraws its recommendation. A break fee must not exceed 1 per cent of the offer value and must be confirmed by the target's financial adviser as being in the best interests of target shareholders. The target board should always seek legal advice before agreeing a break fee with a bidder to ensure full compliance with the Code and applicable legal and regulatory requirements.

The bidder may be able to negotiate a period of exclusivity to pursue its bid for the target. The time and scope of the exclusivity is likely to be restricted, owing to the target board's duties to target shareholders. The scope will usually be limited to the target not actively soliciting competing bids although it will be permitted to consider unsolicited bids. In addition, the target directors are unlikely to want to restrict themselves from soliciting other offers if they do not consider that the one on the table is likely to be the best or only one they will receive.

In addition, as part of any exclusivity arrangements, the target may grant a bidder the right to match a competing offer, that is, it will agree not to recommend a competing bid until the original bidder has had chance to match or better the competing bid.

2.5 Consideration and finance

2.5.1 Forms of consideration

An offer may consist of cash alone, shares in the bidder, some other securities of the bidder such as debentures or loan notes, or any combination of these. Cash has a number of obvious advantages for a selling shareholder. Target shareholders subject to UK capital gains tax may, however, prefer to receive shares or other paper (e.g. loan notes), as they may be able to defer liability for capital gains tax. If the bidder is offering securities, and particularly shares, these would usually be admitted to trading on a recognised stock exchange and so have a reasonable degree of marketability. If the securities are not admitted to trading, as is normally the case with loan notes, the Code requires the bid document to contain an estimate of their value by an appropriate adviser.

2.5.2 Cash or cash alternative offer

If cash is offered, it may come from the bidder's own resources or the bidder may finance its offer by an issue of shares. If it is offering a cash alternative to a share offer, the bidder can arrange for its investment bank or broker to underwrite the offer by agreeing to acquire the consideration shares at the fixed price which accepting shareholders would be entitled to receive if they were to accept the offer for cash. Alternatively, it may finance the cash element of its offer by a rights issue.

2.5.3 Bank finance

The offer may also be financed by bank borrowings. If bank finance is required, the question of security for the borrowings may arise. It is unlawful for a UK company or its UK subsidiaries to give financial assistance (including by way of guarantee, security or indemnity) for the purchase of the company's own (or, in the case of subsidiaries, their holding company's) shares or for the purpose of reducing or discharging any liability incurred in acquiring the shares (section 151 Companies Act 1985). Accordingly, there are restrictions on a bidder agreeing to secure acquisition debt against target assets.

The Companies Act 2006 will, when the relevant provisions come into force (in October 2008), repeal the prohibition on the giving of financial assistance for the acquisition of shares in a private company by the private company itself or by any of its private subsidiary companies. The general prohibition on the giving of financial assistance by a public company for the acquisition of shares either in itself or its public (or private) parent company will be retained. However, in relation to financial assistance proposed to be given in respect of a takeover of a public company, it will be possible for that company to re-register as a private company after the takeover has completed but before the assistance is given in order to avoid the general prohibition applying.

For the time being, however, the financial assistance prohibition complicates having recourse to the target's assets for financing purposes, even after the conclusion of a successful takeover. Pending successful conclusion of a takeover and compliance with

the “whitewash” procedure described below, security available to a lending bank is limited to a pledge of the bidder’s shares in the target (unless the bidder has other assets it can charge).

2.5.4 Financial assistance - whitewash

In certain circumstances, private companies are permitted to give financial assistance (such as granting security over their assets) in connection with the purchase of their own shares, subject to compliance with detailed statutory procedures. To be certain of being able to re-register the target as a private company and authorise the giving of the financial assistance, the bidder will generally wish to acquire 100 per cent of the target’s issued share capital. This can be done either by a scheme of arrangement (see sections 2.6 and 3) or, if the bidder secures 90 per cent acceptances of an offer, by squeeze-out of the minority (see section 9.3). Once the prohibition against giving financial assistance for the acquisition of shares in a private company by the private company itself or any of its private subsidiary companies is abolished in October 2008, it will no longer be necessary to carry out the statutory whitewash procedure.

2.5.5 Cash confirmation

Where cash is offered, the bidder’s financial adviser will need to be satisfied that the cash is in place before the offer is formally announced, as it must confirm in the Rule 2.5 announcement (and the bid document) that sufficient cash resources are available to the bidder to finance the offer (Rules 2.5(c) and Rule 24.7).

The provision of finance must not be subject to unacceptable conditions precedent or a material adverse change condition. The bid document must also describe how the offer is to be financed and the source of the finance (Rule 24.2(f)).

2.6 Bid structure

Tax and accounting issues, as well as more general commercial considerations, will affect the structure of the bid. It has become common for recommended bids in respect of higher value targets to be implemented by scheme of arrangement. Hostile bids are generally structured as contractual offers (whilst theoretically possible to implement a scheme without the support of the target board, there would be significant practical difficulties in doing so). Competing bids are also generally structured as contractual offers for maximum flexibility.

Bidders are able to switch the method of implementation from a scheme to a contractual offer and vice versa, subject to Panel consent. For example, a recommended bid, which begins life as a scheme, may with the Panel’s consent be switched to a contractual offer if a competitive bid situation arises thereby allowing the bidder greater flexibility to adjust its offer terms and respond rapidly to the competing offer. Equally, where the price of a hostile bid is raised to a level acceptable to the target board, the method of implementation may be switched to a scheme of arrangement, with the consent of the Panel.

2.6.1 Scheme of Arrangement

Statutory procedure: A scheme of arrangement is a mechanism provided by the Companies Act 2006 under which a takeover can be effected by the passing of resolutions by target shareholders and with the approval of the Court. The advantages and disadvantages of each are set out below:

Advantages of a scheme: The main points to note about a scheme are as follows:

- unlike an offer, a scheme may be structured so that no stamp duty (currently 0.5 per cent) is paid by the bidder on the acquisition of the target's shares;
- although a scheme requires the approval of a majority in number representing 75 per cent in value of each class of target shareholders voting on the necessary resolutions, once approved, all shareholders are bound by the scheme; and
- whilst a scheme may be slower in terms of acquiring effective control (i.e. 50 per cent), it will generally be quicker in achieving 100 per cent - this means that the target can be re-registered as a private company and be in a position to give financial assistance much more quickly than under an offer.

Implementation of a takeover via scheme of arrangement is considered in more detail in section 3.

2.6.2 Contractual Offer

Offer document: The document, constituting an offer to acquire shares, is sent to target shareholders. Shareholders may then accept the offer either by completing and returning a form of acceptance or by electronic acceptance through CREST. If shareholders accept, they are bound to transfer their shares to the bidder subject to satisfaction or waiver of the conditions of the offer.

Advantages: A takeover structured as an offer does not involve a Court approval process and has certain other advantages over a scheme:

- in order for the offer to succeed (that is for the bidder to acquire control of the target) the bidder needs to achieve any level over 50 per cent of the voting share capital as compared to (broadly) a 75 per cent threshold under a scheme (although in practice on a contractual offer most bidders will wish to acquire 90 per cent in order to squeeze out the minority - see section 6.1.3);
- the timetable to achieve control can be much shorter than in the case of a scheme and, in a recommended offer, control can frequently be obtained within a month;
- it is less cumbersome and more flexible than a scheme and enables the bidder to adjust its terms or to react promptly to a competing offer.

2.6.3 "Newco" and dual holding company structures

"Newco" structure: Occasionally, a new company is formed which makes an offer to acquire the two merging entities.

Dual holding company structure: A cross-border takeover may be structured as a merger using a dual holding company structure which involves the retention of two holding companies in different jurisdictions. By way of a series of contractual arrangements, the businesses of the two holding companies are held jointly whilst allowing the holding companies to retain their own separate legal identities and separate stock exchange listings.

The Panel takes jurisdiction over transactions using both of these structures where one of the companies falls within the scope of the Code even though in both cases neither party acquires control over the other.

2.7 Acting in concert

2.7.1 Definition

Many references will be found in the following sections to "concert parties". These are persons who are deemed under the Code to be "acting in concert" (i.e. acting together) with a party to a bid, that is "persons who, pursuant to an agreement or understanding (whether formal or informal), co-operate, to obtain or consolidate control of a company or to frustrate the successful outcome of an offer for a company" (see the Definitions section of the Code).

Although the definition appears relatively clear, in practice the Panel applies it very broadly and will always look at the facts of a particular situation in order to establish which actions should be treated as those of the bidder or target (as the case may be) for the purposes of the Code.

2.7.2 Presumption of acting in concert

Certain people are presumed by the Code to be acting in concert unless the contrary can be established (for example, a company with its parent and subsidiary companies and with any of its directors). Rebutting these presumptions is generally not easy.

2.7.3 Implications of acting in concert

The concept of acting in concert is perhaps most important in the context of Rule 9, which requires a person to make a general offer for all shares of a company when that person and its concert parties have acquired 30 per cent or more of the voting rights of such company (see section 6.2). The "concert party" concept also has other repercussions under the Code and the implications of acting in concert with a bidder are summarised on page 16. Owing to the significance of these, it is essential for a bidder (or other major shareholders in a Code company) to establish at an early stage who might be considered by the Panel to be its concert parties.

Implications of acting in concert with a bidder

- Persons acting in concert with a bidder *may not sell target securities* during the offer period without the Panel's consent (Rule 4.2).
- When an offer is contemplated but prior to its announcement, persons acting in concert are *prohibited from dealing* in target securities save where the dealing confers no benefit on the concert party (Note 3 on Rules 4.1 and 4.2).
- Acquisitions of interests in securities by persons acting in concert are *treated as acquisitions by the bidder* for the purposes of Rules 5 (timing of acquisitions), 6 (minimum consideration), 9 (mandatory offers) and 11 (nature of consideration).
- Acquisitions made in the 12 months prior to the announcement of the offer (for Rule 9) and acquisitions made in the 12 months prior to commencement of and/or during the offer period (for Rule 11.1) and in the three months prior to and/or during the offer period (for Rules 6 and 11.2) by persons acting in concert will have *an impact on the minimum value of the offer and/or the nature of the consideration to be offered and, in the case of Rule 9, the conditions attached to the offer.*
- Acquisitions by persons acting in concert above the offer price during the offer period will normally result in the bidder having to *increase its offer price* (Rules 6.2 and 11.1).
- Acquisitions by persons acting in concert may result in the Panel refusing consent for a partial offer or a waiver of Rule 9 (Rule 7.3).
- If a concert party is also deemed to be an "associate", daily disclosure of dealings is required during the offer period (Rule 8).
- Concert parties may not enter into deals with favourable conditions with any target shareholders or other persons interested in target voting shares (Rule 16).
- Initial announcement (and subsequent announcements of acceptance levels on a contractual offer) must contain details of, among other things, any interests in target securities (and any short positions) held by persons acting in concert with the bidder (Rules 2.5 and 17.1).
- The bid document must contain details of the identity of any concert parties where this information is needed to enable shareholders to make an informed decision (Rule 24.2(d)(iii) and Note 4 on Rule 24.2).
- The bid document must disclose interests in securities (and any short positions) held in the target and, in the case of a securities exchange offer, the bidder by persons acting in concert and any dealings by them in the 12 months prior to and during the offer period (Rule 24.3).
- The restriction on acquisitions of shares for 12 months after an offer has lapsed or been withdrawn applies to persons who acted in concert during the original offer or who subsequently act in concert (Rule 35.1).
- Acquisitions of interests in shares by persons acting in concert above the offer price are prohibited within six months of the closure of the offer (Rule 35.3).

Note: Once the Panel has ruled that a group of persons is acting in concert, clear evidence will have to be produced to persuade it that this is no longer the position.

3. Schemes of arrangement

3.1	Implementing a takeover by scheme	18
3.2	Types of scheme	19

3.1 Implementing a takeover by scheme

3.1.1 Introduction

A scheme of arrangement is a statutory procedure under the Companies Act 2006 whereby a company may make a compromise or arrangement with (among others) its shareholders (or any class of its shareholders). Once sanctioned by the Court, a scheme of arrangement will be binding on all shareholders (or the class concerned) and upon the company. A takeover can be implemented by scheme of arrangement and, as such, is governed by the Code (see the definition of "Offer" in the Definitions section of the Code).

3.1.2 Scheme process

Schemes of arrangement are generally used to implement recommended bids (as mentioned in section 2, whilst it is at least theoretically possible to implement a scheme without the support of the target board, there would be significant practical difficulties in doing so). To become effective, the scheme must be approved by the target's shareholders by a simple majority in number representing 75 per cent in value of those shareholders of each class present and voting in person or by proxy at a Court-convened meeting (referred to as the Court meeting) and, if necessary, related resolutions may need to be approved by target shareholders in general meeting.

Market purchases do not assist the bidder at the Court meeting because the bidder is not able to vote any shares it holds. In fact, there is greater incentive on a scheme for the bidder and its concert parties not to acquire shares as this has the effect of strengthening the position of any objecting minority wishing to derail the bid. After the Court meeting (and any target general meeting), the scheme (and any capital reduction) must be sanctioned by Court order(s) and the order(s) must be delivered for registration at Companies House (and registered, in the case of a scheme involving a capital reduction) for the scheme to become effective.

3.1.3 Takeover structure

The bidder must decide how to structure its bid. Some of the advantages of implementing a takeover by scheme of arrangement were considered in section 2.6.1. The only real disadvantages of using a scheme are that a scheme: (i) is less flexible than an offer, as all documentation has to be approved by the Court and therefore all material changes to the terms of the scheme also need to be approved by the Court; this may make it harder for a bidder to react quickly if a competing bid arises; (ii) may be slower in terms of acquiring effective control (although it will generally be quicker in achieving 100 per cent ownership as there is no need to implement a squeeze-out procedure); and (iii) gives rise to practical difficulties if the support of the target board is not forthcoming or is withdrawn and therefore is unlikely to be used in hostile situations and may be disadvantageous in competitive situations.

3.1.4 Switching method of implementation

It is possible to switch the method of implementation from scheme to offer, if so required (provided the Panel has consented). If the switch would be likely to reduce "deliverability", the Panel has indicated that it would need to scrutinise the circumstances of the switch more closely. Preparing documentation to facilitate a switch could take a few days in straightforward circumstances, but may take considerably longer if, for example, the switch introduces a requirement to prepare a prospectus.

3.1.5 Scheme timetable

The timing of a scheme and the documentation involved differ from a contractual offer. An outline scheme timetable is set out on page 22. The timetable of a scheme is not strictly governed by the Code in the same way as a contractual offer. In the absence of a competitive bid situation, there is no maximum time limit in a scheme for the holding of shareholder meetings or for the fulfilment of other scheme conditions. There is no equivalent to the 60 day limit as there is for contractual offers. This reflects the fact that scheme timetables will depend on the availability of Court hearing dates. On a competitive bid where one or more of the competing bids is being implemented by scheme, the parties must consult the Panel as to the applicable timetable and the Panel may impose deadlines for obtaining shareholder and/or Court approvals.

The scheme circular must normally be posted within 28 days of the Rule 2.5 announcement (as is the case with an offer document on a contractual offer). Where this is not possible, for example, due to the Court process, the Panel Executive will usually agree to an extension.

Shareholder meetings should normally be held at least 21 days after the date of the scheme circular (except with the consent of the Panel).

3.1.6 Scheme documentation

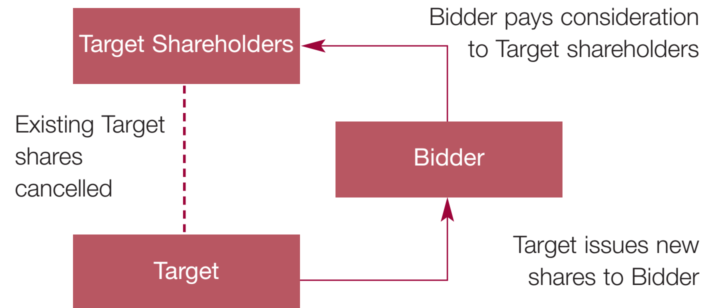
The principal scheme documentation comprises the scheme document, the form of proxy and a form of election (if there is a choice of consideration).

3.2 Types of scheme

There are two different types of scheme - a cancellation scheme and a transfer scheme. It is also possible to structure a takeover using a hybrid of the two.

3.2.1 Cancellation scheme

A cancellation scheme is more common due to the stamp duty saving of ½% of the total consideration payable for the target's shares. On a cancellation scheme, all the shares in the target not already owned by the bidder are cancelled by a reduction of capital of the target. The bidder pays the offer consideration to the target shareholders in consideration for the cancellation of their shares in the target. The reserve created by the reduction in the target's capital is applied in paying up new shares which are issued by the target direct to the bidder with the result that the target becomes a wholly-owned subsidiary of the bidder immediately the scheme becomes effective. As a reduction of capital is involved, it is necessary for an extraordinary general meeting of the target to be held to approve the reduction and the steps required to be taken in connection with it. This meeting is usually convened to be held immediately following the Court meeting to approve the scheme.



On a cancellation scheme, the formalities prescribed by the Companies Act 1985 in relation to a reduction of capital must be complied with in addition to the formalities relating to the scheme. This will extend the scheme timetable. If satisfied that the formalities have been complied with, the Court will confirm the reduction of share capital and sanction the scheme and both the reduction and the scheme will become effective simultaneously on registration of the Court order(s) at Companies House.

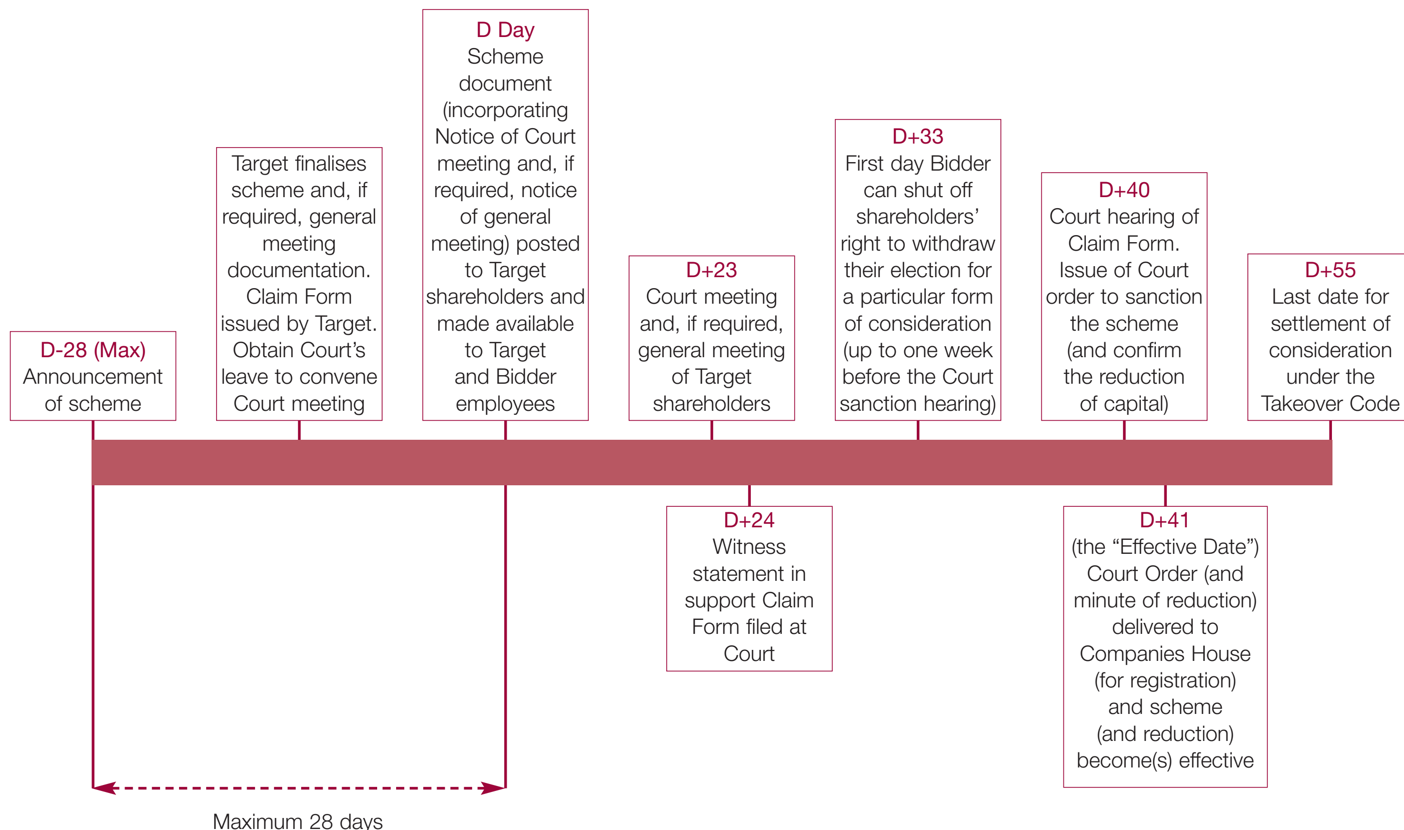
3.2.2 Transfer scheme

Under a transfer scheme, as the name suggests, all of the target's existing shares which are not already owned by the bidder are transferred to the bidder, upon the scheme becoming effective. As consideration is paid by the bidder to the target shareholders in return for that transfer, stamp duty is payable. Since no reduction of capital is involved, a transfer scheme can be completed slightly quicker than a cancellation scheme. Transfer schemes are, however, relatively uncommon, mainly because a cancellation scheme can now be used in circumstances in which a transfer scheme was employed in the past (see section 3.2.3).

3.2.3 Hybrid scheme

In the past, on a securities exchange offer, a scheme involving cash and non-cash consideration would be designed as a combination of a cancellation scheme and a transfer scheme. This could be helpful to achieve a tax-neutral transaction for UK tax paying target shareholders whilst structuring the acquisition of the remaining interest in the target as a cancellation scheme to benefit from the stamp duty saving. However, as it is now possible to use a cancellation scheme and obtain the related stamp duty saving, whilst still securing capital gains rollover relief for shareholders (provided certain conditions are satisfied), hybrid schemes are no longer used very often in practice.

Scheme timeline



The timetable of a scheme is not strictly governed by the Takeover Code in the same way as a takeover offer and will depend on the availability of Court hearing dates. In particular, the Court is closed during Christmas and summer vacations. Note that the shareholder meeting(s) must take place at least 21 days after posting the scheme document to comply with the Takeover Code (unless a derogation is granted by the Panel).

4. Competition

4.1 Impact of competition issues on a takeover 24
4.2 EC Merger Regulation 26
4.3 UK regime under Enterprise Act 29
4.4 Effect of competition regulations on bid timetable 30

4.1 Impact of competition issues on a takeover

4.1.1 Investigation by competition authorities

The EU and UK competition authorities have the power to investigate a takeover offer where certain thresholds are met. The Panel itself has no involvement in deciding competition issues. If a detailed investigation is initiated, an offer will normally be required to lapse while it takes place. It is therefore vitally important at the outset, in order to ensure that the offer goes through with the minimum cost, disruption and inconvenience, for both the bidder and the target to:

- consider the likely reaction of all relevant competition authorities;
- collate the information likely to be required to deal with competition issues; and
- consider possible divestments or other courses of action which could address the anticipated concerns of any relevant competition authority.

Investigations may also be undertaken by other national competition authorities outside the EU. For example, in the US, the Federal Trade Commission and Antitrust Division of the Department of Justice may undertake an investigation of any merger, acquisition or joint venture, regardless of whether the transaction meets pre-merger notification thresholds.

4.1.2 Target defence tactic

In the context of a hostile bid, as a defensive tactic, a target may lobby the competition authorities for a detailed investigation. An offer lapsing will give a target valuable breathing space in which to strengthen its defences and to prepare to ward off any renewed approach. It may also lead to interest from other more welcome bidders.

4.1.3 National or supra-national jurisdiction

Whether a bid is welcome or otherwise, it will first be necessary to determine which competition authority has jurisdiction to examine the takeover. If certain turnover thresholds, which are discussed below, are met, the takeover will fall within the EC Merger Regulation (ECMR). Where the ECMR applies, the European Commission has exclusive power to investigate (the so called "one-stop shop" principle). Where a takeover does not meet the ECMR thresholds, it should be examined to see if it falls within the jurisdiction of the UK Office of Fair Trading (OFT), or possibly other EU national competition authorities. Although whether a takeover falls to be reviewed by the European Commission or one or more EU member states, is determined by the turnover thresholds set out in the ECMR, there is some flexibility to shift jurisdiction despite those thresholds. If a merger will have a significant impact in one or more EU member states, then the national competition authorities of those member states, or the merging parties themselves, can request that, despite the ECMR thresholds having been met, the merger should be reviewed by those national competition authorities and not by the European Commission.

Alternatively, if a takeover does not meet the ECMR turnover thresholds, but is notifiable in at least three EU member states, then the parties can specifically request that the European Commission review the transaction instead, to avoid the administrative burden of several EU filings. There are advantages and disadvantages in each case, in trying to shift jurisdiction and an approach applied in one takeover cannot automatically be applied in another.

Whether or not the takeover falls within the exclusive jurisdiction of the European Commission, national competition authorities outside the EU may also have jurisdiction to investigate the takeover. This can potentially lead to multiple filings. For example, if the target is non-US, but has US sales or assets above a certain threshold level, a pre-merger filing may be required in the US.

4.1.4 Competition clearance prior to completion of takeover

Takeovers falling within the ECMR require pre-notification to the European Commission and cannot be completed pending clearance. For takeovers that are subject to the UK competition rules, there is no legal requirement to notify the competition authorities, either pre- or post-completion. However, in cases where there might be competition issues, clearance is usually sought to avoid the risk of a reference to the Competition Commission. The procedures under the ECMR and the UK regime involve a preliminary evaluation, followed by a detailed investigation in cases where it is thought that there may be serious competition issues.

Most other national competition regimes require pre-notification and suspension of the bid pending clearance. In the US, transactions that meet the pre-merger notification thresholds of the Hart Scott Rodino Antitrust Improvements Act of 1976, as amended, must make a pre-merger filing and observe a statutory waiting period (typically 30 days).

4.1.5 Disclosure of board and shareholder documents when seeking merger clearance

It is important to be aware that where submissions are made to competition authorities, the parties to the transaction are required to supply a large number of documents connected with the transaction. These documents are likely to include board and shareholder meeting minutes, presentations to the board and shareholders and reports and studies prepared for the board, including reports and any other documents prepared by any third party, such as accountants, financial advisers and consultants.

For this reason, care is needed in the preparation of all documents relating to the takeover. Whilst the inclusion of information highlighting the benefits of a transaction cannot be avoided, care should be taken to ensure that documents do not contain material which could prejudice the prospects of the transaction being cleared by the relevant competition authorities. In any event, any relevant documents should not be held back or destroyed since severe penalties can be imposed for such actions.

4.2 EC Merger Regulation

4.2.1 Introduction

The ECMR applies to "concentrations" having a "Community dimension". The definition of concentration is broad and catches cases where companies merge or one company acquires the ability to exercise "decisive influence" over another company. This may occur on the acquisition of a minority shareholding or even of veto rights over strategic decisions alone.

The ECMR has undergone reform. The turnover thresholds set out below remain unchanged. The European Commission wants to encourage more referrals from the European Commission to national competition authorities and vice versa to ensure that the best placed authority acts.

The reform package introduced a number of measures designed to provide the parties concerned with more legal certainty and more transparent decision-making. Parties are able to notify a takeover before conclusion of a binding agreement and the formal requirement to notify within one week of concluding an agreement has been abolished. In fact, the European Commission positively encourages notifying parties to begin communicating with it at the earliest possible stage after the parties have reached a good faith intention to merge. However, obligations of confidentiality should always be considered before approaching any competition authority.

The time frames within which the European Commission can investigate the takeover have been extended by around one week for the initial evaluation and by around three weeks for the detailed investigation.

4.2.2 Thresholds

A "concentration" will have a "Community dimension" where:

- the combined aggregate worldwide turnover of all the parties exceeds €5 billion (this is intended to exclude mergers between small and medium sized companies); and
- the aggregate Community-wide turnover of each of at least two of the parties is more than €250 million (this is intended to exclude relatively minor acquisitions by large companies or acquisitions with only a minor European dimension); unless
- each of the parties achieves more than two thirds of its aggregate Community-wide turnover within one and the same Member State (this is intended to exclude cases where the effects of the merger are felt primarily within a single Member State where it is more appropriate for the national competition authorities to deal with it).

In addition, a concentration that does not meet the above thresholds will nevertheless have a "Community dimension" if:

- the combined aggregate worldwide turnover of all the parties exceeds €2.5 billion; and
- the aggregate Community-wide turnover of at least two of the parties is more than €100 million; and
- in each of at least three Member States, the combined aggregate turnover of all the parties is more than €100 million; and
- in each of the three Member States included above, the aggregate turnover of each of at least two of the parties is more than €25 million; unless
- each of the parties achieves more than two-thirds of its aggregate Community-wide turnover within one and the same Member State.

4.2.3 European Commission reference to national competition authorities and vice versa

In advance of notifying a merger to the European Commission, the parties can request the European Commission to refer the whole or part of the merger back for investigation by the competition authority of a Member State, if the competition effects are felt most in that Member State and it is best placed to examine the transaction. After notification, the European Commission can also refer a merger back to a Member State in similar circumstances. The converse is also possible. The parties to a merger that does not meet the ECMR thresholds, but is capable of being reviewed under the competition laws of at least three Member States, can request the European Commission to examine the merger. Member States can also refer cases to the European Commission where the ECMR thresholds are not met but the merger would affect trade between Member States. Referrals to and from the European Commission whether initiated by the parties or a member state (as described above) will lengthen the overall review timetable.

4.2.4 Calculation of thresholds

The threshold figures need to be calculated by reference to the parties' most recent financial year and official exchange rates (obtained from the European Central Bank and/or the European Commission) must be used to convert national currencies to euros.

4.2.5 Timing of notification

Takeovers caught by the ECMR must be notified to the European Commission and approval must be obtained (subject to limited exceptions) prior to their implementation. There are no fixed time periods within which notification must be made. Notification can only be made following the conclusion of an agreement, after an announcement of a public offer or the acquisition of a controlling interest or in circumstances where the parties can show a good faith intention to conclude an agreement or have publicly announced an intention to make a bid. Notification should only be made once there is no risk associated with the transaction being made public, since the European Commission will look to issue a public announcement soon after notification. However, as mentioned above, merging parties are encouraged to pre-notify confidentially as soon as possible after a good faith intention to merge has been reached. The notification must contain extensive information about the parties and the affected market(s).

4.2.6 Investigation

The European Commission has 25 working days for an initial evaluation of the transaction at the end of which it must either approve it or, if it decides that there are serious doubts as to a transaction's compatibility with the competition rules, it has a further 90 working days to complete a detailed investigation. Both periods are increased where commitments are offered and the Phase II investigation can be further extended in certain other limited circumstances.

4.2.7 Lapse of offer

If the takeover is subject to the Code and it falls within the ECMR, it must be a term of the offer that, in the case of a contractual offer, the offer will lapse if a detailed four-month investigation is instigated prior to the first closing date or the date when the offer becomes or is declared unconditional as to acceptances, whichever is the later and, in the case of a scheme, the bid will lapse and the scheme will not become effective if a detailed four-month investigation is instigated before the shareholder meeting(s) (Rule 12).

If the transaction is cleared (whether conditionally or unconditionally) by the European Commission following a referral, a new offer period will begin at the time of the announcement of the clearance decision and the full range of Code obligations and restrictions will recommence.

4.2.8 Sanctions

The European Commission has the power to block a transaction or to impose conditions (including divestiture) and can impose significant fines in respect of, for example, failing to notify the takeover or supplying incorrect information.

4.3 UK regime under Enterprise Act

4.3.1 Application and thresholds

The Enterprise Act 2002 (EA 2002) requires that a takeover falling outside the ECMR will be subject to UK competition rules if it is a "relevant merger situation" which will be the case where two or more enterprises (one of which is carried on in the UK) cease to be distinct and if either:

- the value of the turnover in the UK of the company being taken over exceeds £70 million; or
- it will create or enhance a 25 per cent share of the supply in the UK (or a substantial part of it) of any goods or services.

4.3.2 OFT procedure

The OFT will conduct an initial evaluation of the merger. It will then decide (without reference to the Secretary of State for Trade and Industry as was previously the case) whether to (i) refer it to the Competition Commission for further investigation; (ii) accept undertakings in lieu of a reference; or (iii) let the merger proceed without further investigation.

4.3.3 Clearance

There is no obligation to pre- or post-notify qualifying mergers in the UK. However, seeking clearance avoids the risk of there being a reference to the Competition Commission further down the line. If the takeover is notified using a statutory Merger Notice, the OFT will have up to 30 working days to consider whether to make a reference to the Competition Commission, consisting of 20 working days for an initial evaluation period which may be extended by a further 10 working days. There is also a non-statutory procedure which generally ensures a decision within 40 working days.

4.3.4 "Substantial lessening of competition" test

In evaluating the takeover, the OFT will examine whether the transaction has resulted, or may be expected to result, in a substantial lessening of competition within any market or markets in the UK for goods or services. Following a Court of Appeal judgment, the threshold for determining whether a merger may be expected to result in a substantial lessening of competition has been interpreted as lower than previously understood. This has led to many more referrals of mergers to the Competition Commission.

4.3.5 Reference to the Competition Commission

If a reference is made, the Competition Commission must act within a fixed timetable. It will have 24 weeks (extendable by eight weeks in certain circumstances) to prepare a report. The Competition Commission will decide what action, if any, to take in respect of the merger.

4.3.6 Informal advice

In certain circumstances, it may be possible to persuade the OFT to give informal confidential advice, also known as a "fireside chat". This is essentially a non-binding oral view of the OFT case team and cannot be taken as the view of senior members of the OFT. The OFT insists that this informal advice is kept confidential by the recipient party. In particular, the receipt of confidential advice must not be disclosed in press releases, bid documents, shareholders meetings or briefings. Disclosure is not even permitted to the other merging party without dispensation. It is therefore common for a joint request for informal advice to be made by both merging parties. Whether or not confidential advice is sought, the OFT does, like the European Commission, encourage parties to enter pre-notification discussions with it.

4.3.7 Lapse of offer on reference

An offer subject to the provisions of the Code must include a term that, in the case of a contractual offer, the offer will lapse if there is a reference to the Competition Commission prior to the first closing date or the date when the offer becomes or is declared unconditional as to acceptances, whichever is the later and, in the case of a scheme, the offer will lapse and the scheme will not become effective if there is a reference to the Competition Commission prior to the shareholder meeting(s) (Rule 12).

If the transaction is cleared (whether conditionally or unconditionally) by the Competition Commission following a referral, a new offer period will begin at the time of the announcement of the clearance decision and the full range of Code obligations and restrictions will recommence.

4.4 Effect of competition regulations on bid timetable

In summary:

4.4.1 If a takeover falls within the ECMR:

- the transaction may not be concluded prior to approval;
- the European Commission has a minimum of 25 working days following notification in which to conduct an initial evaluation;
- if the European Commission decides that the case raises serious doubts and decides to conduct a detailed investigation the bid will normally lapse under the Code. The European Commission must complete the investigation within 90 working days.

The great majority of the agreements notified to the European Commission to date have been cleared within the initial evaluation period and were not subjected to detailed investigation by the European Commission.

4.4.2 If a takeover is a "relevant merger situation" for the purposes of the UK legislation:

- there is no legal requirement to notify the OFT - the system is voluntary;
- the OFT has up to 30 working days to evaluate the transaction if a Merger Notice is submitted;
- if the takeover is referred to the Competition Commission the bid will normally lapse under the Code. The Competition Commission will be given 24 weeks (extendable by eight weeks in certain circumstances) in which to report.

4.4.3 If a takeover falls under the jurisdiction of another national competition authority:

- national competition review waiting periods may need to be complied with;
- the bid will not generally lapse under the Code;
- the transaction may not be able to complete until the relevant national competition authority has had a chance to review the anti-competitive effect of the deal and (i) raised no objections, (ii) given clearance or (iii) sought divestitures or other remedies to cure the anti-competitive effect presented by the deal.

5. Acquiring a strategic stake before a bid

5.1	Introduction	33
5.2	Restrictions on stakebuilding activities	33
5.3	Impact of stakebuilding activities on bid terms	35
5.4	Disclosure	37
5.5	Soliciting shareholder support	39

5.1 Introduction

5.1.1 Tactical advantages

There are a number of advantages to acquiring a stake in the target before announcing an offer. It increases the chances of securing ultimate control of the target and may deter rivals by adding credibility and momentum to an offer. It may also lower the overall cost of the bid as it may be possible to buy shares in the market at a price below the eventual bid price. Also, if a rival does emerge and is ultimately successful at a higher price than the initial bid, the first bidder who acquired a stake may have the consolation of a dealing profit to offset its aborted bid expenses.

5.1.2 Consequences of stakebuilding

While there are tactical advantages to acquiring a strategic stake, it is worthwhile to note that:

- stakebuilding activities which come to the attention of the market are likely to force the target share price up and to that extent may be self-defeating;
- stakebuilding can lead to loss of secrecy and surprise and may trigger an announcement obligation if bid speculation results;
- acquisitions before the offer period may establish a minimum offer price or lead to a requirement to offer a specific form of consideration;
- acquisitions carry the potential for loss if the bid is unsuccessful and no competing bidder emerges; and
- although shares acquired in advance of an offer will count towards the levels needed to secure *control* of the target, on a contractual offer, they can make it more difficult for the bidder to take advantage of the provisions allowing for squeeze-out of the outstanding minority (see section 9) and, on a scheme, market purchases by the bidder at any time have the indirect effect of strengthening the position of any objecting minority wishing to derail the bid.

5.2 Restrictions on stakebuilding activities

Stakebuilding is closely regulated by the Code. The Code provides that market purchases will have certain consequential effects on any subsequent bid and also prohibits acquisitions through certain thresholds (Rule 5). However, the insider dealing and market manipulation and competition legislation may prohibit such share purchases, even though they would otherwise be permitted. The main restrictions to be aware of are set out overleaf:

5.2.1 Criminal Justice Act 1993 - Insider dealing

It is a criminal offence for an individual who has inside information as an insider to deal in securities that are price-affected securities in relation to that information, to encourage another to deal, or to pass on the information. Knowledge of an impending but unannounced offer will be inside information for the purposes of the legislation. However, it should not prevent stakebuilding by the bidder or its agents as there is a defence available to persons acting with a view to facilitating a bid if the only inside information they have is information about the offer, the offer price or the parties involved arising directly out of their involvement in the transaction. This defence would not, however, cover any confidential non-public price sensitive information given to the bidder by the target during the course of negotiations, the receipt of which will prevent a bidder dealing in the target's shares until that information becomes public or a recommended offer is announced.

5.2.2 Financial Services and Markets Act 2000 - Market abuse

A bidder must not engage in behaviour which amounts to "market abuse". Broadly, market abuse is behaviour amounting to insider dealing (including dealing with inside information and improper disclosure) and market manipulation (including conduct likely to create a false market). In the context of a takeover, an example of market abuse is where, on the basis of inside information concerning a proposed bid, a bidder enters into a transaction in target securities that provides merely an economic exposure to movements in the price of the target's shares (for example, cash-settled contracts for differences). Another example is where a person (other than the bidder, for example, a director of the bidder) is aware that an offer is being contemplated and deals in shares or other securities in the target for his own benefit. Knowledge of an impending but unannounced bid by a competing bidder is likely to constitute inside information. Penalties for committing market abuse are either the imposition of unlimited fines or public censure.

Certain behaviour based on inside information relating to another company in the context of a takeover bid for the purpose of gaining control of that company does not of itself amount to market abuse. For example, seeking irrevocable undertakings or letters of intent and making arrangements in connection with the underwriting of a securities exchange offer is permitted. This "safe harbour" covers inside information obtained by a bidder during the due diligence exercise and could be interpreted to permit pre-bid stakebuilding, but in practice the lack of an equivalent provision under the criminal insider dealing provisions (referred to in section 5.2.1) may prevent this.

5.2.3 Enterprise Act 2002 - Competition restriction

A bidder is prohibited, without the consent of the Competition Commission, from acquiring shares in a target after a reference to the Competition Commission has been made until the conclusion of the investigation.

5.2.4 Rule 5

Rule 5 of the Code restricts a person (including its concert parties) who is interested in shares carrying less than 30 per cent of the voting rights of a company, from acquiring an interest in any other shares which would result in an interest in shares carrying 30 per cent or more of the voting rights in the company. In addition, a person interested in shares carrying between 30 per cent and 50 per cent (inclusive) of the voting rights may not acquire an interest in any other shares carrying voting rights in that company. There are various exceptions to the rule, such as where the acquisition is from a single shareholder and it is the only acquisition in a seven-day period. Rule 5 of the Code does not apply where the person has more than 50 per cent of the voting rights.

5.2.5 Listing Rules

Under the Listing Rules, a listed company cannot, without prior shareholder approval, acquire shares for a consideration equivalent to 25 per cent or more of its gross assets, profits, gross capital or its market capitalisation. Shareholder approval may also be required if the bidder is a related party for the purposes of the Listing Rules.

5.2.6 Other restrictions

Other restrictions may impact upon the bidder's ability to stakebuild, for example, regulatory restrictions in certain industry sectors may require consents to be obtained or limit the size of stake that can be acquired. In addition, where the target has securities listed outside the UK, overseas regulators may impose further restrictions.

Detailed legal advice should be obtained before stakebuilding activities are commenced.

5.3 Impact of stakebuilding activities on bid terms

5.3.1 Mandatory offers

Market purchases may have an impact on the terms of any subsequent bid. Bidders should be particularly wary of Rule 9. This provides that where a person acquires an interest in shares which, taken together with shares in which its concert parties are interested, carry 30 per cent or more of the voting rights of a company, that person must make a general cash bid to shareholders. A bidder using a scheme should not trigger Rule 9 unless it first has the Panel's consent to switch the structure to a contractual offer or to make a Rule 9 bid by way of a scheme (Note 2 on Appendix 7.2). The disadvantages of a Rule 9 or mandatory offer are discussed more fully in section 6.2.

5.3.2 Minimum offer price and nature of consideration

Acquisitions before a bid may establish a minimum offer price as an offer must be on no less favourable terms than any acquisitions made in the preceding three months (Rule 6.1). In the case of Rule 9 bids (which must be in cash or be accompanied by full cash alternative), the highest price paid for acquisitions of interests in target shares in the preceding 12 months determines the price at which the offer must be made (Rule 9.5). In the case of voluntary bids, depending on the number of shares or the amount of the interest acquired, a bidder may find it has to make its offer in cash or with a full cash alternative: if an interest carrying 10 per cent or more of the voting rights in target shares is acquired for cash during, and in the 12 months before, the offer period, all shareholders must be offered cash at the highest price paid during that period (Rule 11.1(a)). The acquisition of any interest in target shares for cash during the offer period will give rise to an obligation to make the offer in cash or with a full cash alternative (Rule 11.1(b)). In addition, if an interest carrying 10 per cent or more of the voting rights in target shares is acquired in exchange for securities during and in the three months before the offer period, the bidder will normally be required to offer such securities on the same basis to all shareholders (Rule 11.2).

5.3.3 No special deals

It is a general rule that a bidder cannot enter into special arrangements with selected shareholders or persons otherwise interested in voting shares offering an incentive to deal unless those arrangements are extended to all shareholders (Rule 16). This Rule is considered in more detail in sections 7.5 and 11.5.

5.3.4 Squeeze-out of the minority

On a contractual offer, a bidder must also bear in mind that it must acquire 90 per cent of the shares to which its offer relates to be able to squeeze out the minority. Shares bought prior to posting of the offer document will not count towards this threshold. For more information on acquiring the minority, see section 9.3.

5.3.5 Impact on takeover implemented by scheme

On a scheme, market purchases by the bidder have the indirect effect of strengthening the position of any objecting minority wishing to derail the bid, see section 3.1.2.

5.4 Disclosure

Non-Code requirements

Before a bidder has announced its offer, the principal requirements regarding disclosure of acquisitions of voting rights or interests in shares are contained in the Disclosure and Transparency Rules (for traded companies which are referred to as "issuers" below), the Companies Act 2006 (for public companies) and the Listing Rules (for listed companies).

5.4.1 Disclosure and Transparency Rules

Chapter 5 of the Disclosure and Transparency Rules (DTR 5) require an acquisition or disposal of a notifiable holding of voting rights attached to traded shares (generally 3 per cent or more, or a move through a whole percentage point thereafter for UK issuers) to be notified to the issuer concerned as soon as possible and by no later than two trading days for UK issuers and four trading days for non-UK issuers. Indirect holdings have to be aggregated and separately identified in any notification to the issuer and shareholdings of all persons under the same control must be aggregated for the purposes of DTR 5. Where the holding relates to a listed issuer, the notification must also be filed with the FSA.

The issuer must notify the market via a Regulatory Information Service as soon as possible and by no later than one trading day for a listed issuer and three trading days for all other issuers within the scope of DTR 5. Further changes which take the holding through a whole percentage figure must also be notified, as must changes in particulars previously notified.

5.4.2 Companies Act 2006

An acquisition of any size stake may provoke an investigation into its ownership by the company concerned pursuant to a procedure under the Companies Act 2006.

The procedure, which allows a public company to investigate beneficial holdings underlying its share register, extends to cover the situation where there is an agreement for the acquisition of an interest in shares and requires the interests of the various parties to the agreement to be aggregated for the purposes of disclosure to prevent surreptitious warehousing of shares. There are additional rules on aggregation which are widely drafted. Shareholders of a public company can have their voting rights "frozen" if they fail to disclose information about the underlying beneficial ownership if requested to do so by the company.

5.4.3 Bidder notification under the Listing Rules

A listed company is required to announce the details of any transaction where the price paid exceeds 5 per cent of its gross assets, net profits or its market capitalisation. Separate purchases of the target's shares are aggregated for this purpose.

The disclosure requirements set out in the Disclosure and Transparency Rules, the Companies Act 2006 and the Listing Rules continue to apply throughout an offer in addition to Code disclosure requirements.

Code Requirements

The Code imposes accelerated disclosure requirements to ensure there is no false market in the shares concerned and to prevent prices being manipulated by parties to the bid or persons supporting them.

5.4.4 Offer period triggers dealings disclosure requirements

Once an offer (or possible offer) has been announced in relation to a target, the bidder or possible bidder (and certain other parties connected with it) become subject to the stringent disclosure requirements of the Code (see section 7.7.7). In addition, dealings by any persons who have a 1 per cent or more long position in any class of relevant securities have to be disclosed the following day (Rule 8.3). This will affect any stakebuilding activities by a potential rival bidder if a target is already in an offer period.

5.4.5 Obligation to announce a possible offer

None of the Code's disclosure rules requires the bidder to state its intentions regarding a future offer. However, the Panel may require the bidder to do so if, for example, due to rumour and speculation it deems it necessary to prevent a false market in the shares. When such an obligation arises at a time when the acquiror is contemplating making an offer but is not in a position to be committed to making a firm offer, the bidder is normally permitted to announce merely that it is considering making an offer for the target (Rule 2.4).

5.4.6 Clarification of intentions - "put up or shut up"

Following an announcement of a possible offer, there is no fixed deadline in the Code by which the bidder must clarify its intentions. Where the target is content for the uncertainty to continue, the Panel will not normally seek to intervene in the process. However, in certain circumstances, usually where the potential bidder is unwelcome, the target may request the Panel to intervene by imposing a deadline by which the bidder must clarify its intentions i.e. it must "put up or shut up". A "put up" is communicated by way of a Rule 2.5 announcement and a "shut up" by way of a no intention to bid statement (Rule 2.8). A statement of intention not to make an offer (subject to any reservations agreed with the Panel which set aside such a statement) will normally prevent an offer being made for six months.

5.5 Soliciting shareholder support

5.5.1 Irrevocable undertakings and letters of intent

An alternative to buying shares in advance of an offer is for a bidder to obtain from certain key shareholders, irrevocable undertakings or letters of intent to accept its offer once it is made or to vote in favour of (or against) a resolution including a resolution to approve or give effect to a scheme of arrangement. Irrevocable undertakings are normally obtained from the target board in recommended offers. Institutional shareholders may also be approached on a confidential basis and a bidder may be keen to obtain such undertakings or statements of intent to demonstrate the maximum possible support for its proposed bid. Compared with a shareholder selling in the market or directly to the bidder, the advantage of these arrangements for shareholders is that they usually allow them to obtain the benefit of any increased offer price. Irrevocable undertakings often provide that the undertaking will cease to apply in the event of a competing offer or a competing offer above a specified price. On the other hand, letters of intent are by their nature non-binding, giving the shareholder flexibility to change its mind, if a higher competing offer is made.

5.5.2 Gathering of irrevocable commitments

Irrevocable undertakings (unlike letters of intent) count as interests in securities for the purposes of Rule 5 and should therefore be prepared by the bidder's legal advisers. Contact with shareholders should be made through the bidder's financial adviser. The Panel regulates the gathering of irrevocable undertakings from individuals and small corporate shareholders (Rule 4.3).

6. Acquiring control

6.1	Control	41
6.2	Mandatory bids (Rule 9) and voluntary bids	41
6.3	Partial offers	45
6.4	Code whitewashes	46

6.1 Control

6.1.1 Acquisitions up to but not including 30 per cent

A potential bidder is permitted to acquire an interest in up to 29.9 per cent of the voting capital of the target without triggering an obligation to make a mandatory cash offer to all shareholders. A potential bidder may therefore attempt to acquire interests up to this level before attempting to gain control of the target by means of its takeover bid.

6.1.2 Legal control

Control of a company is generally considered to be the ability to determine the outcome of shareholders' meetings and the composition of the target board. The percentage majority required for most shareholders' resolutions (including those for the appointment and removal of directors) is a simple majority (i.e. over 50 per cent) although some require 75 per cent (for example, amendments to a company's constitution). Legal control is therefore achieved with any holding of greater than 50 per cent of the voting rights and, under the Code, an offer may not become unconditional unless the bidder achieves at least this level.

6.1.3 Absolute control

In practice, it is unusual in the UK for a successful takeover offer to end with anything less than absolute control of the target, i.e. 100 per cent of the voting rights. Following a successful scheme, absolute control is guaranteed. On a contractual offer, once a bidder has acquired 90 per cent of the shares to which its offer relates, it has the right to squeeze out the minority (see section 9.3). The major advantage of owning the entire share capital is flexibility in what can be done after the acquisition has been completed without concerns about actions for unfair prejudice being brought by the minority under the Companies Act 2006. In addition, the bidder then receives all dividends paid by the target without dividend "leakage" to minority shareholders.

On pages 42 and 43, there is a summary of legal and regulatory implications of shareholdings at various percentage levels.

6.2 Mandatory bids (Rule 9) and voluntary bids

6.2.1 30 per cent threshold for effective control under the Code

Although legal control is achieved once 50 per cent of a company's voting rights are acquired, a holder of less than 50 per cent can often, in practice, exert significant influence and control over the affairs of a company. Accordingly, a holding of 30 per cent of a company's voting rights is deemed under the Code to confer effective control.

Summary of legal and regulatory implications of interests in UK companies at various percentage levels

Any amount	■ may be required to disclose details of persons with any interest upon request (section 793 Companies Act 2006) ■ any dealing giving rise to rumour, speculation or an untoward movement in the company's share price (around 10 per cent) may mean an announcement has to be made (Rule 2.2) ■ bidder, target or associate required to disclose any dealings in relevant securities during an offer period (Rules 8.1 and 8.2) ■ any dealing by a person discharging managerial responsibilities must be notified within four business days - DTR 3 (listed company must also notify a Regulatory Information Service) ■ any acquisition made within the three month period prior to the commencement of the offer period or during the period, if any, between the start of the offer period and a Rule 2.5 announcement will mean that the offer must be on no less favourable terms (Rule 6.1) ■ any acquisition for an amount in excess of the offer price after the offer is announced and before the offer closes for acceptance will require revision of the offer (Rule 6.2) ■ any dealing for cash during the offer period may lead to a requirement for a cash offer or cash alternative (Rule 11.1(b))
1 per cent	■ a person with a 1 per cent or more long position must disclose any dealings made during an offer period (Rule 8.3)
3 per cent	■ must disclose holdings of voting rights to an issuer whose shares are admitted to trading on a regulated or prescribed market (DTR 5) and the issuer must also notify a Regulatory Information Service ■ subsequent changes in voting rights must be disclosed if holding reduced below 3 per cent or increased or reduced through a whole percentage point
5 per cent	■ disclosure level (rather than 3 per cent) for certain persons including investment and unit trust managers (DTR 5.1.5R)
10 per cent	■ right to requisition a general meeting (5 per cent in relation to many private companies) (section 303 Companies Act 2006)

10 per cent in a year	■ possible requirement for cash offer or cash alternative (Rule 11.1)
10 per cent in 3 months prior to offer period	■ possible requirement for a securities exchange offer if consideration includes securities (Rule 11.2) (obligation to make cash offer/cash alternative under Rule 11.1 unless seller consideration shares locked up)
29.9 per cent	■ maximum limit to avoid Rule 9 offer
30 per cent	■ effective control acquired under the Code ■ requirement to bid for whole of target on achieving 30 per cent or increasing any holding between 30 per cent and 50 per cent (Rule 9) ■ may be prohibited from making further acquisitions (Rule 5)
Any amount over 50 per cent	■ subsidiary (and subsidiary undertaking) and legal control; power to pass ordinary resolutions and thereby appoint/remove directors, approve dividends, increase authorised capital, authorise director to allot shares, etc ■ offer capable of becoming unconditional as to acceptances (Rule 10) (a mandatory offer under Rule 9 must become unconditional at this level) ■ Rule 5 and Rule 9 of the Code cease to be applicable
75 per cent	■ power to pass special resolutions including resolution for re-registration as a private company, resolution to approve financial assistance and liquidation, amendments to constitution ■ necessary vote to pursue a scheme of arrangement (section 899 Companies Act 2006) ■ power to pass resolution to delist shares
90 per cent	■ on a contractual offer, the minority may be entitled to require the bidder to buy their holdings (section 983 Companies Act 2006)
90 per cent of shares subject to offer	■ on a contractual offer, power to squeeze out the minority (section 979 Companies Act 2006)
95 per cent or more	■ minority shareholders have no specific power to prevent re-registration as a private company

6.2.2 Mandatory offer trigger

It is a fundamental principle of the Code that where effective control passes, other holders of securities must be protected (General Principle 1). Rule 9 therefore requires that, except with the consent of the Panel, an offer must be made to all other shareholders (and to holders of certain other target securities) by any person who acquires, whether by a series of transactions over a period of time or otherwise, interests in shares carrying 30 per cent or more of the voting rights of a company. Such offers are referred to as "Rule 9" or "mandatory" offers. A similar obligation applies to a person who increases a stake of between 30 per cent and 50 per cent. Acquisitions by persons acting in concert are aggregated for these purposes.

6.2.3 Structure of mandatory bid

Although a mandatory offer should normally be satisfied by means of a contractual offer, the Panel does have discretion to consent to a Rule 9 bid being implemented by scheme. If the Panel permits the mandatory offer obligation to be satisfied by means of a scheme, a bidder would be required to make a contractual offer if the scheme lapses for a reason which would not have caused a contractual offer to lapse, for example, because a resolution to approve and give effect to the scheme receives more than 50 but less than 75 per cent approval at the shareholder meetings or the scheme is not sanctioned by the court. A bidder using a scheme should not trigger Rule 9 unless it has first obtained the Panel's consent to switch the structure to a contractual offer or to make a Rule 9 bid by way of scheme.

6.2.4 Terms of mandatory bid

Rule 9 offers must be in cash, or be accompanied by a full cash alternative, so that if target shareholders do not approve of the controlling shareholder they can exit completely rather than being offered only shares in the bidder. Such bids must be at a price not less than the highest price paid by the bidder or any of its concert parties in the preceding 12 months, in order that all shareholders can benefit from the premium paid for control (Rule 9.5), and can only be conditional on acceptances for more than 50 per cent of the voting rights (Rule 9.3(a)). This may lead to the situation where a mandatory bid becomes wholly unconditional but the bidder receives insufficient acceptances to squeeze out the minority. The Code also provides that acquisitions of shares should not be made which would trigger Rule 9 if the offer would be dependent on any other conditions, for example, shareholder approval (Rule 9.3(b)).

6.2.5 Disadvantages of a mandatory offer

The obvious disadvantages of Rule 9 offers, being the requirement that they are for cash and the restrictions on their conditionality, make them unpopular with bidders, who tend not to go through 30 per cent before announcing their offer. Instead they generally choose to make a voluntary offer, having possibly acquired a lesser number of shares, in their own time and on the terms and conditions they deem appropriate.

6.2.6 Rule 9 applicable during voluntary offer

Section 7 refers to the types of conditions to which offers are generally subject. One condition that must be included in all types of offer is the bidder acquiring over 50 per cent of the voting rights (Rule 10). This threshold can be set higher, but never lower. A bidder can carry on buying shares in the market during the course of its offer and these, as well as acceptances of the bid on a contractual offer, will count towards the 50 per cent level (see section 3.1.2 for the impact of market purchases on schemes). Note that Rule 9 continues to apply during a voluntary offer (see section 7.7.2). For this reason, any market purchases or other acquisitions of interests in shares are often kept to a maximum aggregate holding (including concert parties) of 29.9 per cent. Acceptances of a contractual offer are not counted towards the 30 per cent threshold for Rule 9 purposes.

6.2.7 Acceptance condition on voluntary offer

A voluntary contractual offer will usually be made conditional on the bidder receiving acceptances in respect of at least 90 per cent of the shares to which its offer relates. Only if this level of acceptances is achieved will the bidder have the right to squeeze out the shares of non-accepting shareholders and thereby obtain 100 per cent of the share capital (see section 9).

6.2.8 Waiving down the acceptance condition

In practice on a contractual offer, the bidder will reserve the ability to relax, and will in due course often relax, the 90 per cent condition by reducing the threshold to such number of acceptances as will, when taken with shares the bidder already owns, exceed 50 per cent of the target's voting share capital. The consent of any banks financing the offer will, however, generally be required before the acceptance condition can be relaxed or "waived down" to below 90 per cent.

6.3 Partial offers

An offer is usually made for all shares of the target not owned by the bidder. Offers to obtain less than 100 per cent are rare in the UK. Partial bids require special Panel consent (Rule 36.1). If a partial bid is made for more than 30 per cent of the voting rights, it must be conditional upon the approval of the offer by shareholders of at least 50 per cent of the voting rights not held by the bidder or connected parties (Rule 36.5). Shareholders who oppose the offer can vote against it, but will still be able to sell the relevant proportion of their shares at the offer price if the partial offer succeeds.

6.4 Code whitewashes

Major transactions may occasionally involve substantial issues of new shares by public companies. This may happen, for example, when shares are issued as consideration for an acquisition or new funds are provided by way of a share subscription. Where such an arrangement would lead to a person (or a number of persons acting in concert) holding over 30 per cent of the voting shares of the company, this would normally trigger a mandatory bid obligation under Rule 9. However, there is a procedure under the Code whereby such an obligation can be waived if there is an independent vote at a shareholders' meeting and a majority (voting on a poll) approve the acquisition of the relevant stake by the incoming controlling shareholder. This dispensation is known as "whitewash" and the detailed requirements are set out in Appendix 1 to the Code. It is important to note that a "whitewash" is only possible where the relevant person or persons will exceed the 30 per cent threshold following an *issue* of new shares and not where a transfer of existing shares is involved. Full information and independent advice must be provided to shareholders so they can vote on a fully-informed basis.

7. Making a bid

7.1	Introduction	48
7.2	Announcing the bid	53
7.3	The bid document	54
7.4	Employee share schemes	59
7.5	Special deals	61
7.6	Documents for the bidder's own shareholders and employees	62
7.7	Share dealings during the course of the bid	62

7.1 Introduction

7.1.1 Formal offer

A formal bid is made, in the case of a contractual offer, by an offer document and, in the case of a scheme, by scheme circular, in each case sent to the target's shareholders. The formal bid follows the Rule 2.5 announcement of the bidder's firm intention to make the offer. The Rule 2.5 announcement includes the conditions of the bid and principal terms. The offer must first be communicated to the board of the target or its advisers (Rule 1). Until an announcement is made, absolute secrecy must be observed (Rule 2.1).

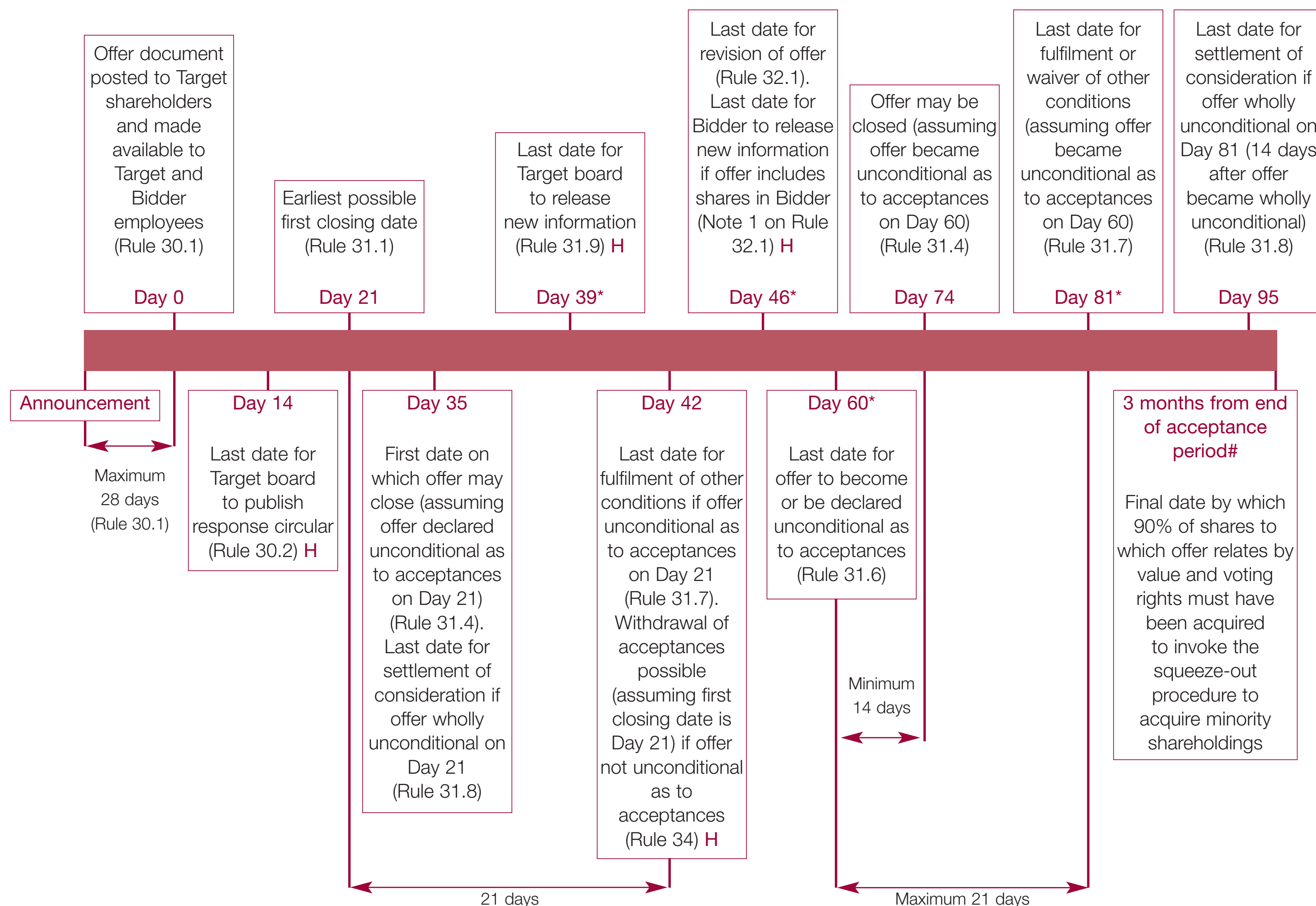
7.1.2 Announcement to the market

Prior to release of the Rule 2.5 announcement, the Panel may require an immediate announcement to be made if there is rumour and speculation about a bid or a significant movement in the target's share price, irrespective of whether the bidder or target considers such an announcement to be premature. Responsibility for making such an announcement rests with the bidder until an approach has been made to the target, after which the target must generally assume responsibility. The Panel has emphasised the need for the relevant company's advisers to consult the Panel in such circumstances and to have procedures in place to monitor share prices and take steps, such as preparing draft announcements and establishing arrangements for their immediate release, to ensure that the relevant company is able to react swiftly, if so required.

7.1.3 Commencement of offer timetable

Once the bidder has announced a firm intention to make an offer, on a contractual offer, the Code requires adherence to a strict timetable. See section 3.1.5 for information on the timetable applying to a takeover implemented by scheme. The offer timetable attempts to strike a balance between giving shareholders sufficient time to decide on the merits of a bid and preventing companies from coming under siege for an excessive period of time. The offer document or scheme circular must be posted within 28 days of an offer being announced (unless the Panel consents otherwise). On a contractual offer, the bidder must receive sufficient acceptances to be able to declare its offer unconditional as to acceptances by the 60th day after posting the offer document. Otherwise the offer must lapse (Rule 31.6), unless the parties agree a timetable extension. Generally the bidder cannot renew its offer for 12 months without target board agreement (Rule 35). An outline bid timetable applying to a contractual offer is set out on page 49.

Offer Timeline



H Normally only relevant in the context of a hostile bid or competitive bid situation.

* Subject to extensions agreed by the Panel.

The offer is likely to remain open (i.e not be closed to acceptances) until after the squeeze-out so this period is at least theoretically indefinite (although bid financing costs will usually result in a prompt squeeze-out).

Note: The timeline assumes receipt of competition clearances prior to Day 39 and no competitive bid.

Terminology: Offer can (and normally will) **remain open** after Day 81 (until holders of 100% of voting shares have accepted or the squeeze-out procedure has been completed). **"Open"** means capable of being accepted so as to constitute a binding contract.

7.1.4 Standards of care and responsibility statements

The Panel regulates closely all documents issued to shareholders, all advertisements published in connection with an offer and all statements made during its course but does not formally review or approve them prior to publication. The same standard of care applies to documents and advertisements whether issued by the company itself or by an adviser on its behalf. They must be prepared with the highest standards of care and accuracy and the information given must be adequately and fairly presented (Rule 19.1). Directors are required to take responsibility for all documents issued to shareholders and advertisements published in connection with an offer. A responsibility statement to that effect must be included on the face of the document or advertisement (Rule 19.2).

7.1.5 Profit forecasts and merger benefits statements

The general requirement for absolute accuracy is reflected in specific rules of the Code relating to certain types of information contained in a bid document such as profit forecasts, asset valuations and merger benefits (or synergy) statements. Where a profit forecast or asset valuation is included in a bid document, the Code provides that such information must generally be independently reported on. Where a statement is made about the expected financial benefits of a proposed takeover, the party making such a statement must in certain circumstances establish not only the basis for such a belief, but also must obtain and include, in the bid document, an independent report from both its financial adviser and its accountants, confirming that such statement has been made after due care and consideration (Note 8 on Rule 19.1). Statements relating to improved earnings per share, or any earnings enhancement statements, which are not intended to be profit forecasts, must include prominent disclaimers to the effect that the statement should not be interpreted as meaning that earnings will necessarily be greater than those for a relevant preceding financial period. The principal aim of the provisions regarding merger benefits and improved earnings statements is to ensure that parties to offers cannot overstate their case for tactical reasons and to ensure that statements are properly understood by the market and do not confuse shareholders (Rule 28.6).

7.1.6 Misrepresentation, directors' duties and the Listing Rules, Disclosure and Transparency Rules and Prospectus Rules

The importance of ensuring that takeover documentation meets the highest standards of care and accuracy is not just a question of best practice and due compliance with the Code. Any misrepresentation may lead to both civil and criminal liability. Criminal liability may arise as a result of a breach of section 397 of the Financial Services and Markets Act 2000 (FSMA) (see page 51). Liability may arise if the directors, whether knowingly or recklessly, make any misleading, false or deceptive statement or dishonestly conceal any material fact in connection with such statement, or do any act which creates a false or misleading impression as to the market in or the price or value of any investments, if that statement is made or that act is done for the purpose of inducing a person to acquire or dispose of those investments.

Section 397 Financial Services and Markets Act 2000

Misleading statements and practices

(1) This subsection applies to a person who -

(a) makes a statement, promise or forecast which he knows to be misleading, false or deceptive in a material particular;
(b) dishonestly conceals any material facts whether in connection with a statement, promise or forecast made by him or otherwise; or
(c) recklessly makes (dishonestly or otherwise) a statement, promise or forecast which is misleading, false or deceptive in a material particular.

(2) A person to whom subsection (1) applies is guilty of an offence if he makes the statement, promise or forecast or conceals the facts for the purpose of inducing, or is reckless as to whether it may induce, another person (whether or not the person to whom the statement, promise or forecast is made) -

(a) to enter or offer to enter into, or to refrain from entering or offering to enter into, a relevant agreement; or
(b) to exercise, or refrain from exercising, any rights conferred by a relevant investment.

(3) Any person who does any act or engages in any course of conduct which creates a false or misleading impression as to the market in or the price or value of any relevant investments is guilty of an offence if he does so for the purpose of creating that impression and of thereby inducing another person to acquire, dispose of, subscribe for or underwrite those investments or to refrain from doing so or to exercise, or refrain from exercising, any rights conferred by those investments.

Directors of the bidder and target respectively must ensure high standards of accuracy to avoid liability for negligent or fraudulent misrepresentation. They must also keep in mind their duties as directors. Companies subject to the Disclosure and Transparency Rules and/or the Listing Rules must comply with the standards of accuracy set out therein when issuing information to the market and a company issuing a prospectus or equivalent document must prepare it in accordance with the requirements set out in the Prospectus Rules. A listed company must also bear in mind the FSA's Listing Principles and, in particular, Listing Principle 4 which requires the company to communicate information to shareholders in such a way as to avoid the creation or continuation of a false market in its shares.

7.1.7 Market abuse regime

Liability may arise under the market abuse regime if any misleading information is published which gives a false or misleading impression as to the price of a company's shares.

7.1.8 Financial promotion regime

Documents prepared and issued in connection with a takeover should not generally need to be issued and/or approved by an authorised person (i.e. a financial adviser) under the financial promotion regime set out in FSMA as they are likely to benefit from an exemption.

7.1.9 Sufficient information

As it is for the target's shareholders to decide whether their company should be taken over or not, the Code requires them to be provided with sufficient information in order to consider the merits of the bid and reach a properly informed decision (Rule 23). The Code contains detailed contents requirements for the various documents which are also subject to the general requirement that all relevant information should be made available on a timely basis to all shareholders. The main aim is to ensure shareholders receive information in sufficient time to make their decision.

7.1.10 Advertisements

The Panel takes a very restrictive approach to advertising (see Rule 19.4) as it is concerned that shareholders be given full information of a factual nature supplemented by reasoned argument. The Panel will not tolerate takeover battles being waged through advertisements in the media. Parties to an offer and their advisers are required to take care not to issue statements which, whilst not factually incorrect, may mislead shareholders and the market.

7.1.11 Dissemination of information

Whilst the Code emphasises the importance of all relevant information being relayed to shareholders, bidders are not allowed to release information to selected shareholders only, for example, when meeting with institutional shareholders. Inherent in the principle of fair and equal treatment of all shareholders is that any material new information released must be relayed promptly to all shareholders. In order to ensure that this takes place, an appropriate representative of the financial adviser or corporate broker of the bidder is required to police any such meetings (Note 3 on Rule 20.1).

The Code also regulates press campaigns and circumstances where small numbers of shareholders are contacted by telephone.

7.2 Announcing the bid

7.2.1 Pre-conditional announcements

The Panel generally only permits pre-conditional Rule 2.5 offer announcements in limited circumstances, for example, where the merger of the two companies concerned is likely to raise competition issues. In such circumstances, it is possible for the bidder to make the posting of the offer subject to satisfaction or waiver of a pre-condition relating to the obtaining of regulatory clearances from the relevant competition authorities. Where the announcement states that an offer will be made once the pre-conditions are satisfied or waived, the bidder must in those circumstances proceed with an offer. There are no restrictions on the types of pre-conditions permitted in possible offer announcements made under Rule 2.4, although the possible offer announcement must state whether the pre-conditions are waivable and include a warning that there is no certainty that any offer will in fact be made even if the pre-conditions are satisfied or waived.

7.2.2 Consequences of making a Rule 2.5 announcement

Once a bidder has announced a firm intention to make an offer under Rule 2.5, it must then proceed with the offer (Rule 2.7). Only in the most exceptional circumstances will the Panel release a bidder from this obligation. A bidder should therefore only announce its intention to make an offer once it has every reason to believe that it can, and will continue to be able to, implement the offer in full (Rule 2.5(a)).

If in order to complete the bid, the bidder needs, for example, to borrow funds, it must make sure that these are committed before the announcement (General Principle 5 and Rule 2.5(c)).

7.2.3 Disclosure in the Rule 2.5 announcement

When a firm intention to make an offer is announced, the identity of the bidder and the full terms of the offer must be disclosed, including all conditions to which the offer is subject. These can only be altered subsequently with the Panel's consent. The announcement must contain, among other things, details of all interests in target securities held by the bidder and any concert parties and details of securities in respect of which the bidder or its associates has procured an irrevocable undertaking or letter of intent (Rule 2.5(b)).

7.2.4 Circulation to shareholders

The target board is required to circulate promptly the Rule 2.5 announcement (or a summary of its terms) to its own shareholders (Rule 2.6). Where an announcement of a possible offer is made before the announcement of a firm intention to make an offer, the target board must circulate the possible offer announcement to its shareholders. The target and bidder must also make the Rule 2.5 announcement available to their respective employees or employee representatives. This requirement will usually be satisfied by placing the announcement on the respective company's website.

7.3 The bid document

7.3.1 Posting

The offer document or scheme circular containing details of the bid should normally be posted to the target's shareholders within 28 days of the Rule 2.5 announcement (Rule 30.1). The document may be posted considerably earlier, particularly in a hostile bid where the bidder will wish to minimise the time the target has to marshal its defences. The target will be required to append to the bid document an opinion, from its employee representatives, on the effect of the offer on employment, provided the opinion is received "in good time". Where there is a short period of time between publication of the Rule 2.5 announcement and the bid document, there is less likelihood that the opinion would be received prior to publication. This would be advantageous where the opinion runs contrary to the views of the target board. Where the opinion is not received in time, there is no obligation on the target to circulate the opinion subsequently. The bidder will typically want the document to be posted as soon as possible where an underwritten cash alternative or rights issue is involved. This is because the underwriting commissions are based on the length of the underwriting period, which begins when the offer is announced.

7.3.2 Principal documents on a takeover

If the offer is recommended, the offer document or scheme circular will be a joint document issued by the two boards. If it is a hostile offer, the offer document will be issued by the bidder alone. A bidder may also need to produce a circular to its own shareholders if it needs shareholder approval to implement the offer (see section 7.3.5) and/or a prospectus or equivalent document if it is offering securities to target shareholders (see section 7.3.11). A comparison of the principal documents required to be produced by the bidder and target, on both hostile and recommended bids is set out on page 55. More information on the principal scheme documentation is set out in section 3.1.6. The principal content requirements for the bid document, as set out in Rule 24 of the Code, are summarised on page 56.

7.3.3 Contents of bid document

The bid document will contain details about the bidder, its offer and the types of consideration available and it will repeat the conditions of the offer or scheme which were set out in the press announcement. On a recommended offer, the bid document contains a letter from the chairman of the target recommending acceptance of the offer or approval of the scheme and explaining the reasons behind the recommendation. If it is a hostile bid, the offer document will be of a more aggressive nature and will contain arguments to persuade target shareholders to accept the offer.

Comparative table of principal documents involved in recommended and hostile offers

Recommended	Hostile
Press Announcement (Bidder/Target) (Rule 2.5)	Press Announcement (Bidder) (Rule 2.5)
	Press Announcement rejecting offer (Target)
Offer Document (or Scheme Circular) (Bidder/Target) (Rules 24 and 25)	Offer Document (Bidder) (Rule 24)
Class 1 Circular to Bidder shareholders if required (Bidder)	Class 1 Circular to Bidder shareholders if required (Bidder)
Prospectus/equivalent document if securities exchange offer and securities to be offered to the public or admitted to trading on a regulated market (Bidder)	Prospectus/equivalent document if securities exchange offer and securities to be offered to the public or admitted to trading on a regulated market (Bidder)
	Defence Document (Target) (Rule 25)
	Response Document (Bidder), Further Defence Document(s) (Target) and Further Response Document(s) (Bidder) (Rule 27)
	Revised Offer Document, where applicable (Bidder) (Rule 27)

Bid document content requirements

Rule 24 of the Code requires:

- details of the securities for which the offer is made, the basis on which they will be acquired, the total consideration offered and, in the case of a securities exchange offer, the amount of shares of the bidder which the bidder has redeemed or purchased during the offer period
- particulars of procedures to be followed for acceptance of the offer or approval of the scheme
- middle market quotations for target's securities and any securities offered in exchange on the first dealing day of the preceding six months, on the day before the offer was announced and on the last practicable day before the bid document is posted
- details of any bidder securities to be issued as consideration and the effect of a successful bid on the bidder's capital and income position
- details of the financing of the offer
- a statement of the bidder's intentions regarding the target and its employees
- three year financial statements of the bidder and target including audited balance sheets and any interim statements as well as any subsequent material changes (less onerous requirements for listed cash bidders)
- the names of the directors of the bidder and target
- details of the nature of the bidder's business and its financial and trading prospects
- a summary of the principal contents of each material contract entered into outside the ordinary course of business by any member of the bidder group in the previous two years
- details of interests in target securities and, in the case of a securities exchange offer, in bidder securities (and any short positions) held by the bidder, its directors and its concert parties together with details of any dealings in the securities of either company by any of the above in the preceding 12 months
- in the case of a securities exchange offer, details of any effect of the offer on the emoluments of the bidder's directors
- details of any special arrangements between the bidder or any of its concert parties and any of the existing or recent directors or shareholders of the target relating to the bid
- where the offer is for cash or includes an element of cash, confirmation by an appropriate third party that sufficient resources are available to the bidder to settle the bid consideration in full
- details of break fee agreements and other agreements relating to the invocation of conditions; and
- details of irrevocable undertakings and letters of intent

The bid document must also incorporate language reflecting all relevant requirements of the Code as to the terms and conditions of the offer (including timing requirements)

Notes:

Rule 25 sets out the information required to be provided by the target. This information would be found in the offer document or scheme circular on a recommended bid and in the defence document on a hostile bid (see page 69 for a summary of the principal content requirements in Rule 25).

Rule 27 requires subsequent documents sent to shareholders to contain details of any material changes in previously published information.

Where the consideration is to be solely in cash and there is a negligible risk of a minority being retained in the target, certain disclosures regarding the bidder and its financing are disapplied.

7.3.4 Bid documentation offence

The Companies Act 2006 contains a criminal offence for non-compliance with certain contents requirements for offer and defence documentation. The offence only applies to contractual offers for targets with voting securities admitted to a UK regulated market (e.g. the main market of the London Stock Exchange). Offer documentation prepared in connection with a takeover implemented by scheme or contractual offers for companies whose securities are admitted to AIM or other unlisted markets, therefore, fall outside the scope of the offence.

The offence can be committed by the person making the bid and its directors, officers and members who caused the offer document to be published as well as the target's directors and officers. An offence will only be committed where the relevant person knew that the document did not comply or was reckless as to whether it complied and failed to take all reasonable steps to secure compliance. The offence increases the focus on ensuring that an appropriately thorough and considered verification exercise is undertaken in order to reduce the risk of committing the offence.

7.3.5 Bidder shareholder consent

If the bidder is a listed company and the offer is of such a size as to require the consent of its own shareholders under the Listing Rules (or equivalent rules), the obtaining of this consent will also be a condition of the bid.

7.3.6 Competition reference

If an offer falls within the terms of reference of the Competition Commission or within the scope of the ECMR then it must also be a term of the offer that it will lapse should the offer be referred to the Competition Commission or if the European Commission intervenes before the later of the first closing date or the date when the offer becomes unconditional as to acceptances, on a contractual offer, or before the shareholder meeting(s) on a scheme (see section 4).

7.3.7 Additional conditions

Broadly, the bidder has a discretion to decide the conditions to which the bid should be subject, unless it is a Rule 9 offer (see section 6). The majority of the conditions will relate to the state of the target's business and will be similar to the warranties which a purchaser might expect to receive in a private company acquisition, such as:

- there having been no material adverse change in the target's circumstances since its last published accounts; and
- there being no material contracts or arrangements to which the target is party which contain provisions enabling the other party to terminate in the event of a change of control.

The bidder's ability to invoke such conditions is, however, very limited (see section 7.3.10).

7.3.8 Mutual conditions

On a recommended bid, where the offer is structured as a securities exchange offer, the board of the target may wish to ensure that the consideration securities received by the target's shareholders have a value which is not materially different from that contemplated by the target board at the time that it gives its recommendation. Mutual conditions or "offeree protection conditions" are more likely to be a feature on mergers where the bidder and target companies are of a similar size (referred to as a "merger of equals"). The target should not invoke any offeree protection conditions unless the circumstances giving rise to the right to invoke are of material significance to target shareholders in the context of the offer (Rule 13.5).

7.3.9 Subjective conditions

Subjective conditions are not normally permitted (Rule 13.1). The Panel may be prepared to accept an element of subjectivity in certain special circumstances where it is not practicable to specify all the factors on which satisfaction of a particular condition may depend, for example, in the context of competition conditions.

7.3.10 Policing bid withdrawals

The Panel polices withdrawals from bids on the basis of non-satisfaction of conditions to ensure that any proposed withdrawal is genuine and reasonable and that the circumstances are of material significance to the bidder in the context of the offer. In practice, it is extremely difficult to obtain the Panel's consent to invoke a condition (other than the acceptance condition on a contractual offer, the statutory conditions on a scheme or, in either case, the regulatory conditions) to withdraw from a bid, as the Panel's materiality threshold is very high.

7.3.11 Prospectus or equivalent document

If the consideration for the bid includes securities of the bidder, then unless an exemption is available, the bidder will either need to: (i) elect to prepare and send a prospectus to target shareholders which will contain financial and other information on the bidder and on the securities to be listed; or (ii) or prepare and send an equivalent document, instead of preparing a prospectus, pursuant to the takeover exemption in the Prospectus Rules.

7.3.12 Overseas resident shareholders

The minimum requirement in the Takeovers Directive is that information and bid documentation must be made readily and promptly available to the holders of target securities at least in those member states on whose regulated markets the target's securities are admitted to trading and to the representatives of the employees of the target and the bidder or, where there are no such representatives, to the employees themselves.

Subject to limited derogations, the Code requires that the relevant information must be provided to all shareholders and employees/employee representatives wherever they may be (including, potentially, those resident in jurisdictions into which such materials may not have been distributed in the past). The Panel has discretion to grant a derogation from the requirement to provide bid documentation to target shareholders resident outside the EEA where to do so would cause disproportionate problems under local securities and other laws. The Panel has indicated that this derogation will not normally apply in respect of such persons resident within any EEA member state.

As regards employees/employee representatives (as opposed to shareholders), the Code does not require that a copy of the relevant information or document be sent to all employees/employee representatives; it must simply be made available to them. Accordingly, this obligation should be satisfied by placing the information on an appropriate part of the company's website. This requirement to provide information does, however, apply in respect of all full-time and part-time employees on a group-wide basis wherever they may be located subject only to a very limited derogation equivalent to the one referred to above.

Compliance with these requirements imposes significant additional cost and timing burdens on the parties to a takeover in order to check applicable local securities laws and regulations in certain non-EEA jurisdictions.

Even where the bidder does manage to secure a dispensation in respect of posting the bid document into certain overseas jurisdictions, the document will still provide that, although the bid is not being made into those jurisdictions, it is still being made to all shareholders. Takeovers implemented by scheme may benefit from a lighter regulatory regime in overseas jurisdictions because they do not involve an offer for securities and a scheme is supervised by the Court. Offers can be made under the rules and procedures of two or more jurisdictions and such dual offers are increasingly being made in the US and UK where there are significant target shareholdings in the US.

7.4 Employee share schemes

7.4.1 Share option schemes

Most UK quoted public companies operate one or more employee share schemes which give employees the right to acquire shares in the company. The most common type of scheme has traditionally been the share option scheme although in recent years companies have been moving towards using long-term incentive plans (LTIPs) for their directors and senior executives. There are two main categories of option scheme - executive share option schemes and savings-related share option schemes (often referred to as sharesave schemes). Participation in executive share option schemes is normally limited to directors and senior employees. By contrast, employees at all levels can take part in a savings-related share option scheme. Under such a scheme, employees are granted options provided that they agree to make regular savings which can be used to buy the shares.

Options granted under either scheme cannot normally be exercised earlier than three years after the grant of the options. The exercise of executive options is also normally dependent on the company meeting certain performance conditions.

7.4.2 Scheme rules applicable on a takeover

In the event of a takeover, most option schemes and LTIPs allow participants to exercise their options or acquire shares under their LTIP awards (although possibly only on a time pro-rated basis) for a limited period after the offer has been declared wholly unconditional. Performance conditions attaching to the exercise of executive options may be waived, in whole or part, in these circumstances, although for LTIP awards and more recent option grants, it is likely they will be measured up to the change of control. Once optionholders have exercised their options, they are likely to accept the offer, assuming it remains open for acceptance, or sell their shares on the market.

7.4.3 Code treatment of option schemes

In addition, Rule 15 obliges the bidder to make an "appropriate proposal" to optionholders to ensure that their interests are safeguarded. The proposal may be no more than informing optionholders that they can exercise their options and accept the offer. The target board must obtain independent advice on the proposal and make known the substance of that advice to optionholders, together with the board's views on the proposal. As a result of Rule 15, target optionholders are often given a number of alternatives to exercising their options, which may include:

- the opportunity to exercise executive options on a cashless basis, for example, by using a proportion of the proceeds of sale of the target shares they acquire on option exercise under the offer, to fund the option exercise price;

- the opportunity to exchange options held over shares in the target for equivalent options over shares in the bidder. Exchanging options can preserve valuable tax benefits for optionholders in tax-approved executive and savings-related share option schemes and provide a continuing share incentive;

- compensation for participants in savings-related share option schemes. Holders of savings-related share scheme options can only exercise their options to the extent of savings made in their savings accounts. They will not therefore be able to exercise their options in full if they have not completed their savings. As a result, it is common for a bidder to make a bonus payment to compensate for the "lost" profit as a goodwill gesture. The payment is normally based on the additional profit that the optionholders would have made if they had been able to save for a longer period (usually between two and six months) and use those additional savings to buy further shares; or

- increasingly less common, the opportunity to surrender options in exchange for a cash payment from the bidder. The payment would be equivalent to the gain that the optionholder would have made if they had exercised their options, acquired shares in the target and then sold those shares on the terms of the offer. Although payments for the surrender of options were common in the past, there are tax disadvantages for both optionholders and the employing company in using this route.

It is normal for a letter to be sent to the target's optionholders setting out the proposals together with a form enabling them to make their choice(s).

7.4.4 Other employee share schemes

In addition to share option schemes, many UK companies have share schemes under which employees can buy shares, or under which shares are distributed to employees free of charge. The Code does not require the bidder to make any special proposals in relation to these types of scheme, although it would be normal for there to be communications to participants explaining the impact of the offer on their share awards. The precise implications of an offer for these types of scheme will depend on their rules and how the offer is structured.

7.5 Special deals

7.5.1 General prohibition

A bidder cannot enter into special arrangements with selected shareholders or persons otherwise interested in voting shares offering an incentive to deal unless those arrangements are extended to all shareholders (Rule 16). This reflects the general principle that all shareholders of the same class must be afforded equivalent treatment. This general prohibition applies at any time during which a bid is reasonably in contemplation, throughout the offer period and continues for a period of six months from the closing of any successful offer (Rules 16 and 35.3). The scope of this prohibition is very wide. Accordingly it can drive the structuring of the deal and require extensive consultation with the Panel.

7.5.2 Management buy-outs and other exceptions

On a management buy-out or similar transaction, the management of the target may be offered an equity interest in the bidder (or other incentivisation arrangements). Such arrangements are likely to offend the principle of equality of treatment of all shareholders if they are not extended to every shareholder. The Panel may be prepared to consent to such arrangements provided certain conditions are complied with; for example, an independent adviser to the target must confirm in the bid document that it considers the arrangements to be fair and reasonable in the context of the bid so far as other target shareholders are concerned and independent shareholders' consent must be obtained in respect of rollover arrangements; the Panel should be consulted (Note 4 on Rule 16). See section 11 in relation to particular Code issues arising on an MBO or similar transaction.

7.6 Documents for the bidder's own shareholders and employees

7.6.1 Bid document and prospectus/equivalent document

The bidder will usually send its own shareholders a copy of the bid document (the offer document or scheme circular) and prospectus/equivalent document (if any) for information purposes. Rule 30.3 now requires, among other things, that the bidder makes bid documentation readily and promptly available to its employee representatives or, if there are none, its employees (see section 7.3.12).

7.6.2 Circular

If a bidder is a listed company, the consent of the bidder's own shareholders may be required, depending upon the size of the target in relation to the bidder or the number of new shares to be issued. In this case, a circular containing details of the bid and the target must be circulated to them, together with notice of the general meeting at which the approval is sought. The contents of the circular are prescribed by the Listing Rules (where applicable).

7.7 Share dealings during the course of the bid

7.7.1 Restrictions imposed on bidder share purchases

It is in principle permitted for the bidder to continue buying shares in the target during the course of the bid, but there are certain restrictions imposed by the Code.

7.7.2 Mandatory offer can be triggered during offer

Rule 9 (mandatory offers) continues to apply during the course of the bid. This means that if there is an acquisition of interests in shares which increases the aggregate interests of the bidder and its concert parties (excluding acceptances of the offer) to 30 per cent or more of the voting rights, the bidder will be required to make a revised offer for the outstanding shares of the target at a price not less than the highest price paid for the interests in shares by the bidder or its concert parties during the previous 12 months. In such a case, the revised offer can only be made conditional on acquiring over 50 per cent of the voting rights of the target. All other conditions to which the offer was subject prior to triggering the Rule 9 offer therefore have to be dropped.

7.7.3 Timing of share purchases

Another rule of the Code, Rule 5, restricts the speed at which interests in shares can be acquired, if the aggregate resulting interest amounts to 30 per cent or more of the voting rights. This applies both generally and during a bid. A number of exceptions exist, but even if one is available Rule 9 may still apply.

7.7.4 Consequences of share dealing during bid

There are two other rules of the Code which do not prohibit purchases of shares by the bidder as such but instead give rise to certain consequences. If, during the offer period, interests in target shares are acquired at above the offer price, the offer must be revised immediately to reflect the terms of such acquisition if they are more favourable than the terms of the offer (Rule 6.2).

If the bidder does not intend to offer cash generally, it (and its concert parties) should not acquire any interests in target shares at all for cash during the offer period. If it does, it will need to make a revised offer in cash or accompanied by a cash alternative (Rule 11.1).

Acquisitions of interests in target shares in exchange for securities during the offer period will normally require a cash offer at a price based on the value of the securities at the time of purchase, unless the recipient of the consideration securities is subject to a lock-up until after the offer lapses or the consideration is posted (Note 5 on Rule 11.1). If the bidder does not intend to make a securities exchange offer, the bidder (and its concert parties) should restrict acquisitions of interests in target shares in exchange for securities to less than 10 per cent of the voting rights (Rule 11.2). If the offer is required to be amended by Rule 6, 9 or 11, an immediate announcement is required (Rule 7.1).

7.7.5 Prohibition on bidder disposal of target securities

During the offer period, the bidder and its concert parties must not sell any securities in the target except with the prior consent of the Panel and after having given 24 hours' public notice that such sales might be made (Rule 4.2). The bidder and its concert parties are then prohibited from making further acquisitions of interests in target securities.

7.7.6 Insider dealing and market abuse

The constraints imposed by the statutory provisions on insider dealing and market abuse, and by the Listing Rules continue to apply during the course of the offer (see section 5.2).

7.7.7 Disclosure requirements

The provisions regarding disclosure of share purchases in the Disclosure and Transparency Rules, Companies Act 2006 and the Listing Rules (see section 5.4) continue to apply. Rule 8 of the Code imposes additional accelerated disclosure requirements in relation to dealings in:

- target securities (which include those for which an offer is being made or which carry voting rights), equity share capital and all securities carrying conversion or subscription rights into any of such securities; and
- on a securities exchange offer only, the equivalent securities and securities which carry substantially the same rights as the consideration securities.

Dealings include entry into or closing out of options in respect of, or derivatives referenced to, securities and any action resulting, or which may result, in an increase or decrease in the number of securities in which a person is interested or in respect of which a short position is held.

During the offer period (which starts with the announcement of a proposed or possible offer), dealings by the bidder, the target or any associates for their own account or for discretionary fund management clients have to be disclosed to a Regulatory Information Service by noon the next business day (Rule 8.1) and dealings by any person who has a 1 per cent or more long position in the securities of the bidder or target must be so disclosed by 3.30 p.m. on the next business day (Rule 8.3). Dealings by the bidder, the target or any associate for non-discretionary fund management clients must be privately disclosed to the Panel (Rule 8.2).

7.7.8 Definition of "associate"

"Associate" is defined very widely and includes any person who owns or deals in the shares of the bidder or target and who has an additional interest, whether commercial, financial or personal, in the outcome of the offer. It encompasses, amongst others, members of the same group of companies as the bidder or target (including 20 per cent associates), advisers to both sides (and persons in common control with such advisers), the directors of any members of the bidder's or target's group, their pension funds and employee benefit trusts (see Definitions section of the Code and Note 6 on Rule 8).

7.7.9 Prohibition on share purchases by target's financial adviser and broker

The financial adviser and broker to a target are prohibited from acquiring interests in target shares during the offer period (Rule 4.4). This is to address the concern that, particularly in hostile offers, such dealings might alter the final outcome of the bid and thereby frustrate the wishes of shareholders generally.

8. The Defence

8.1	Introduction	66
8.2	To recommend or to defend?	67
8.3	The defence document	67
8.4	Defensive measures	68
8.5	Directors’ duties to the company	70
8.6	The next moves	71

8.1 Introduction

8.1.1 Target response to bid

A board which receives an approach is entitled to be satisfied that the bidder will be able to implement the offer in full (Rule 1). The target board is required to obtain competent independent advice (generally from a financial adviser and referred to as the Rule 3 adviser) on any bid and to make the substance of this advice known to its shareholders (Rule 3.1). The target board's first direct contact with shareholders will be when it sends them the press announcement of the offer or possible offer (Rule 2.6). If the announcement is of a firm intention to make an offer, and the offer is not to be made on a recommended basis, the target board may decide at this stage not to advise shareholders to accept or reject the offer but instead tell them to do nothing, to retain their shares and await events.

8.1.2 Bid defence manual

A bid defence manual is primarily intended to be an information pack (prepared ahead of any bid approach), to assist the target and its advisers in reacting to an unsolicited or hostile bid situation. Having a defence manual and carrying out appropriate housekeeping work should allow the target to react quickly to events while avoiding delays or mistakes due to lack of co-ordination.

8.1.3 Defensive tactics

Once an offer has been made, or after the target board has reason to believe that an offer may be imminent, the board is severely restricted in the defensive actions which it may take. In general terms, the target may not, without the approval of its shareholders in general meeting, take any action which could effectively result in the offer being frustrated or in shareholders being denied an opportunity to decide on its merits (General Principle 3 and Rule 21.1). The limits on frustrating action are discussed in section 8.4.

8.1.4 Standards of care in preparation of defence-related documents

All requirements regarding availability and quality of information for shareholders described in section 7.1 apply equally to defence documents prepared by the target board. In summary:

- all documents, advertisements and statements made relating to the bid are strictly regulated by the Panel;
- adequate information must be made available to all shareholders to enable them to decide on the merits of a bid; no relevant information should be withheld;
- documents must be prepared to the highest standards of care and accuracy. They must bear on their face a statement that the directors accept responsibility for the information included;

- civil and criminal liability may result from any false or misleading statements (negligent or fraudulent misrepresentation and sections 118 (market abuse) and 397 (misleading statements and practices) of FSMA and, on Takeovers Directive bids where the target's voting securities are admitted to a UK regulated market, section 953 (bid documentation offence) of the Companies Act 2006);
- Listing Rules must be complied with by listed targets;
- telephone campaigns and small meetings with shareholders are closely regulated so as to ensure no new information is made available only to a selected few; and
- the publication of advertisements is severely limited.

8.2 To recommend or to defend?

8.2.1 Target board deliberations

If the target board thinks the offer undervalues the company, or securities are being offered as consideration and the target has concerns about the bidder itself, it may be justified in rejecting the offer and advising shareholders to do the same. The target board must be guided in its deliberations by General Principle 3 of the Code: the target board must act in the interests of the company as a whole.

8.2.2 Directors' duties on agreeing to recommend offer

Target directors must give careful consideration before entering into any commitment (in their capacity as directors) with a bidder (such as an undertaking to recommend its offer) which would restrict their freedom to advise shareholders in the future. Such commitments may lead to conflicts of interest or result in a breach of the directors' duties to the company. Directors' duties are discussed more fully in section 8.5.

8.3 The defence document

8.3.1 Communication of rejection of offer

A separate defence document will be prepared in the case of a hostile takeover in which the target board will set out its reasons for not recommending the offer. The target board must append to its defence document an opinion of its employee representatives on the effects of the offer on employment (if the opinion is received in good time). The defence document must normally be sent to target shareholders within 14 days of publication of the offer document and be made available to employees (Rule 30.2).

8.3.2 Contents of defence document

In the defence document, the board is required to make known its views on the offer and the substance of the independent advice it has received (Rule 25.1). If the board is split, the minority directors must also publicise their views. There is a general requirement for the target to comment on the bidder's stated intentions for the company and its employees (Rule 25.1). The principal content requirements for the defence document as set out in Rule 25 of the Code are summarised on page 69.

See section 7.3.4 in connection with the bid documentation offence in the Companies Act 2006 which applies to offer documents and defence documents. The bid documentation offence applies to the target directors and other officers.

8.3.3 Formal defence wording

The most difficult part of the document to prepare is the formal defence, with the reasons why shareholders should reject the offer. This will be contained in a letter from the chairman of the target, which is included in the document. The defence may be framed as an attack on the terms of the offer and, where bidder securities are being offered as consideration, the bidder itself. It is not unusual for the tone and content of documents on a hostile bid to become increasingly aggressive as the offer proceeds.

8.3.4 Financial information on the target

As part of the defence, the target board may decide to provide shareholders with detailed information about the financial position and prospects of the target so as to demonstrate that the offer price is inadequate. This may involve the inclusion of a profit forecast or an asset valuation. A profit forecast must be reported on by the auditors or reporting accountants and by the target's financial adviser and any asset valuation must be supported by an independent valuer. Any profit forecast made before the offer period must be repeated and reported on in the defence document (Rule 28). There are also certain timing restrictions on the provision of new information such as profit forecasts (see section 8.6).

8.4 Defensive measures

8.4.1 General prohibition on frustrating action without shareholder consent

Rule 21.1, which prohibits the target board from taking *any* action which may result in any offer or bona fide offer being frustrated without shareholder consent where a target board has received an approach, or has reason to believe an offer might be imminent, is based on the premise that it is for shareholders alone to determine the outcome of the bid (General Principle 3). If the proposed action is in pursuance of a contract entered into earlier or another pre-existing obligation or decision of the target board, the Panel must be consulted and its consent to proceed without a shareholders' meeting obtained.

Defence document content requirements

Rule 25 of the Code requires:

- the views of the target board (including minority views if the board is divided in its opinion) on the offer (including any alternative offer) and the substance of the advice received from the independent advisers;
- the views of the target board on the bidder's plans for the target and its employees;
- details of interests in securities of the bidder and the target (and any short positions) held by:
  - the target
  - target directors
  - the target's subsidiaries, pension funds and employee benefit trusts
  - advisers to the target and certain associates and other parties

  together with details of any dealings in securities of either company by any of the above between the start of the offer period and the latest practicable date prior to posting;
- details of all known material changes in the target's financial or trading position since the last audited accounts or a negative statement;
- a statement as to whether the target directors intend to accept or reject the offer in respect of their own beneficial shareholdings;
- particulars of all service contracts of any director or proposed director of the target or any of its subsidiaries, and details of any variations made in the previous six months;
- details of any conflict of interest any target director may have;
- a summary of the principal contents of each material contract entered into outside the ordinary course of business by any member of the target group in the previous two years;
- details of irrevocable undertakings and letters of intent;
- details of the number of shares of the target which the target has redeemed or purchased during the period commencing 12 months prior to the offer period.

Notes:

On a recommended offer, the information required by Rule 25 is provided in the bid document (the offer document or scheme circular) which is prepared jointly by the bidder and the target.

Rule 27 requires subsequent documents sent to shareholders to contain details of any material changes in previously published information.

It should, however, be noted that the board of a company is, subject to directors' fiduciary duties, free to put in place defence planning initiatives (e.g. poison pills) at any time when an offer is not in contemplation (although these are very rarely employed in the UK).

8.4.2 Specific frustrating action prohibited

Rule 21.1 contains a general prohibition against taking frustrating action without shareholder approval and also specifically prohibits the following actions without obtaining shareholders' or Panel consent (in the case of a pre-existing obligation or decision):

- issuing further share capital (or transferring/selling shares out of treasury);
- issuing or granting options in respect of unissued shares;
- creating or issuing any securities bearing rights of conversion into or subscription for shares;
- selling, disposing of or acquiring assets of a material amount or agreeing to do so; or
- entering into contracts otherwise than in the ordinary course of business.

Even before a bid has been publicly announced, if it is in reasonable contemplation, a target board will be severely restricted in the defensive actions which it may take.

8.4.3 Board changes and variations to directors' service contracts and pension scheme arrangements

The Panel will regard amending or entering into a service contract with, or creating or varying the terms of employment of, a director as being outside the ordinary course of business for the purposes of the above rule if this results in an abnormal increase in the emoluments or a significant improvement in the terms of service. The Panel must be consulted in advance, in these circumstances, and in the case of a promotion or new appointment. Changes to a target's pension scheme arrangements may fall within the above rule and again the Panel should be consulted.

8.5 Directors' duties to the company

8.5.1 Directors' duties in general

Legal duties owed by directors to their company may also restrict the defensive measures a board may take. Directors are required to act in a way that they consider, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole. They also owe a general duty of care in managing the company's affairs. It is permissible for directors to use their powers in order to attempt to defeat a hostile takeover if, acting in good faith, they think such action is most likely to promote the success of the company.

However, as they are required to exercise their powers for the purpose conferred, unless there is an independent corporate benefit, "poison pill" actions to discourage a bidder may well be deemed to be for a collateral purpose and therefore constitute a breach of the directors' duties.

8.5.2 Target permitted to lobby competition authorities to secure a reference

One legitimate defensive measure which is often employed is lobbying the competition authorities to secure a reference. If an offer is referred, the offer lapses pending investigation by the relevant competition authority. This, of course, does not guarantee the target's independence but secures it a valuable breathing space (see section 4). Alternatively a target may try to seek out a preferred suitor willing to offer better terms, commonly referred to as a "white knight".

8.6 The next moves

8.6.1 Minimum period for offer to remain open

An offer must remain open for a minimum of 21 days from the date the offer document is posted. Day 21 is therefore usually known as the first closing date. An offer will usually be extended beyond the first closing date.

8.6.2 Bidder may increase offer price

If the market is convinced by the defence document that the offer is too low, the bidder may be forced to increase its offer in order to succeed. The earliest this is likely to happen is the first closing date (Day 21) when an announcement will be made of the acceptances received. It is, however, more usual for a bidder to wait until later in the offer timetable before increasing its offer. If a revised offer is made, all shareholders who have accepted the original offer will be entitled to receive the revised consideration (Rule 32.3).

8.6.3 Continued defence by target

If the target continues to fight the bid, any revised offer document sent to shareholders will be followed by a further defence document. The last day the bidder may revise its offer is Day 46 as any revised offer is required to be kept open for 14 days (Rule 32.1) and the offer must become or be declared unconditional as to acceptances by Day 60. If the bidder has announced its offer to be final (referred to as a no-increase statement) it cannot subsequently increase it (Rule 32.2). The exceptions to this are if a competitive situation arises or the target board decides to recommend an offer, but only if the bidder has specifically reserved the right to revise its offer in such circumstances.

8.6.4 Deadline for release of new information by target

Day 39 is the last day on which the target may release material new information such as trading results or a profit forecast (Rule 31.9). The target may choose not to disclose such information until this date to give the bidder as little time as possible to revise its offer and secure the necessary acceptances. Where the target is aware of a matter which might give rise to such an announcement being made after Day 39, the target must make every effort to bring the announcement date forward. When this is not practicable or the matter arises after that date, the Panel will normally give its consent to a later announcement. If such an announcement is made after Day 39, the Panel will normally be prepared to grant an extension to Day 46 (offer revision deadline) and Day 60 (deadline to satisfy acceptance condition).

8.6.5 Rights of withdrawal of acceptances

In general, acceptances of an offer may not be withdrawn. However, if the offer has not become unconditional as to acceptances by 21 days after the first closing date (usually 42 days after the offer document is posted) accepting shareholders are entitled to withdraw their acceptances (Rule 34).

9. Declaring the offer unconditional and completing the acquisition

9.1	Unconditional as to acceptances	74
9.2	Going wholly unconditional	74
9.3	Acquiring the minority on a contractual offer	75
9.4	Removing the target board	76
9.5	Cancelling the target's listing	77

9.1 Unconditional as to acceptances

9.1.1 Deadline for declaring offer unconditional as to acceptances

On a contractual offer, it will normally be the bidder's objective to declare its offer unconditional as to acceptances as quickly as possible. The Code deadline for this is Day 60. If the offer has not become or been declared unconditional as to acceptances by Day 60, it must lapse (Rule 31.6). The Panel can agree to grant an extension to this date, but will only do so if:

- a competing offer has been announced (both bidders are then usually bound by the timetable established by the posting of the competing bid document);
- the target board consents to such an extension; or
- Day 39 has been extended to permit the target to publish new information at a later date (because, for example, the OFT has not yet decided whether to refer the offer).

9.1.2 Calculating the level of acceptances

On a contractual offer, on Day 21 (the usual first closing date), the bidder will aggregate acceptances received and shares already held or bought in the market. There are strict rules for determining which acceptances and purchases may be counted towards fulfilling the acceptance condition (Notes 4, 5 and 6 on Rule 10). By 8.30 a.m. on the following business day, the bidder must announce the acceptance level achieved (Rule 17.1).

If the appropriate level of acceptances has been achieved, it may declare the offer to be unconditional as to acceptances. If the acceptance condition has not been satisfied, it may announce an extension of the offer or a revised offer or where possible, waive down the 90 per cent acceptance condition (usually to 75 per cent, subject to any financing conditions of lending banks). In such cases, the next closing date must be announced. Alternatively, it may abandon its offer.

9.1.3 Minimum 14-day period after going unconditional as to acceptances

When the offer is declared unconditional as to acceptances, it must then be left open for at least another 14 days. Generally it will be left open for longer or until further notice to achieve the greatest possible number of acceptances.

9.2 Going wholly unconditional

9.2.1 Fulfilment of remaining conditions

On a contractual offer, the bidder has 21 days after declaring its offer unconditional as to acceptances to ensure that all the other conditions of its offer are fulfilled (Rule 31.7). If they are not fulfilled or waived within that period, the offer must lapse. For this reason, the bidder may delay declaring its offer unconditional as to acceptances if there is concern that any outstanding condition (such as a competition authority clearance) may not be satisfied within 21 days.

9.2.2 Posting of consideration to accepting shareholders

The bidder must post the consideration to shareholders within 14 days of the offer becoming wholly unconditional or the scheme becoming effective. On a contractual offer, to the extent acceptances are received subsequently, the consideration must be posted within 14 days of their receipt (Rule 31.8).

9.3 Acquiring the minority on a contractual offer

9.3.1 Untraced shareholders

A bidder is very unlikely to receive acceptances of its offer in respect of 100 per cent of the shares in the target. There will be, for example, shareholders who cannot be traced or who are unable to accept the offer due to local securities laws restrictions.

9.3.2 Statutory procedure for squeeze-out of minority

The Companies Act 2006 contains a procedure allowing a bidder to acquire compulsorily the shares held by the outstanding minority and so acquire 100 per cent of the target once the bidder has acquired 90 per cent of target shares to which the offer relates (section 979 Companies Act 2006).

9.3.3 Implementation of statutory procedure

To invoke the statutory procedure in relation to an offer to which the Code applies, the bidder must squeeze out the minority within the three months following the period allowed for acceptance of the bid. The 90 per cent threshold relates to the value of, and voting rights attached to, the shares to which the offer relates.

"Shares to which the offer relates" excludes shares held by, or contracted to be acquired by, the bidder at the date of the offer. Shares purchased before the offer document is posted cannot therefore be counted, but any bought during the course of the offer (provided they are acquired on the same terms as the offer) can be included.

9.3.4 Procedural steps

Assuming the 90 per cent threshold is met in the prescribed time, the bidder will then issue a notice to non-accepting shareholders enabling the squeeze-out of their shares (squeeze-out notice). On the date falling 6 weeks after service of the squeeze-out notice, the shares must be acquired on the same terms and conditions as the final offer, with all alternatives offered at the outset being available.

9.3.5 Right of minority shareholders to be bought out

Just as the bidder can oblige the dissenting minority to sell, so the dissenting minority can oblige the bidder to buy their shares (section 983 Companies Act 2006). The bidder is required to serve a notice on dissenting shareholders within one month of acquiring nine-tenths in nominal value of the shares of the target, unless a squeeze-out notice is sent instead (see above). The notice must give non-accepting shareholders the right, for a minimum period of three months from the end of the acceptance period, to require the bidder to purchase their shares on the terms of the final offer or on such other terms as may be agreed.

9.3.6 Squeeze-out not available if 90 per cent acceptances not received

It is possible that the bidder will not achieve 90 per cent acceptances and therefore will not have the benefit of the squeeze-out provisions. It may be happy to be left with an outstanding minority, or, if it has not already done so, it may refuse to declare the offer unconditional as to acceptances and let it lapse. It is, however, common for a bidder to waive down the required acceptance level to below 90 per cent on the basis that declaring the offer unconditional as to acceptances will generally trigger a further stream of acceptances, usually resulting in the required 90 per cent threshold for squeeze-out being reached. The bidder is not allowed to offer enhanced terms to the last few shareholders for at least six months after the offer has closed as the Code demands equivalent treatment for all shareholders.

9.3.7 Tactics on a hostile bid to trigger acceptances

In a hostile bid, if the bidder decides to waive down the 90 per cent acceptance condition (subject to any financing conditions of lending banks) and declare the offer wholly unconditional, the target board is likely to recommend the offer (as the bidder at that point has legal control of the target). Once the offer is wholly unconditional and recommended, sufficient acceptances are generally received to enable the bidder to invoke the squeeze-out procedure.

9.4 Removing the target board

9.4.1 Resignation of the board

It is customary for the executive members of the target board to resign upon the bidder achieving control (other than those participating in an MBO or otherwise continuing in their roles after the change of control). The non-executive directors may stay on until the squeeze-out has been completed to protect the interests of the remaining minority shareholders. Following a hostile offer, however, the bidder may insist on the whole board resigning as soon as it declares its offer wholly unconditional.

9.4.2 Forceful removal of directors on hostile bid

In the unusual (though not unknown) situation that the incumbent board refuses to resign, a successful bidder will be able to remove the directors by using its shareholding to requisition a shareholders' meeting, although this may take up to three months. A resolution of a simple majority of votes removing the directors would be passed at the meeting.

9.4.3 Compensation for loss of office

Whether the incumbent directors go voluntarily or not, the executive directors will usually be entitled to contractual compensation for their loss of employment.

9.5 Cancelling the target's listing

Having obtained legal control of a listed target, a bidder will almost always delist target shares. Among other rules applicable on delisting, the Listing Rules contain a requirement that listed companies must obtain the consent of 75 per cent of shareholders in general meeting prior to cancellation of listing. There is, however, an exception to the shareholder approval requirement where a bidder holds or has received acceptances in respect of at least 75 per cent of the target's share capital pursuant to a contractual offer or where a bidder obtains control of the target following a takeover implemented by scheme of arrangement. The shareholder approval requirement was introduced as an investor protection measure as delisting or the threat of delisting of target shares was considered an effective weapon in hostile bids making the target shares illiquid and compelling shareholders to accept an otherwise unattractive offer. The effectiveness of this weapon has been weakened by the introduction of the new delisting rules, but can still be employed once the 75 per cent threshold has been reached.

10. Consequences of an unsuccessful bid

10.1	Lapse of contractual offer	79
10.2	Lapse of scheme	79
10.3	Resultant bidder stake in target	79
10.4	Disposal of target securities	79
10.5	Code restrictions preventing immediate launch of new offer	79
10.6	Expiry of Code restrictions on new offer	80

10.1 Lapse of contractual offer

As explained in section 9, if a bidder does not achieve sufficient acceptances to be able to declare its offer unconditional as to acceptances by Day 60, the offer must lapse unless both parties agree an extension of this deadline with the Panel. The offer must also lapse if, having declared the offer unconditional as to acceptances, the other conditions are not satisfied within 21 days (Rule 31.7).

10.2 Lapse of scheme

On a scheme, if target shareholders fail to approve the scheme or the Court refuses to sanction it, the scheme will lapse. In this case, the bidder will have the choice either to walk away from the deal or consider launching a contractual offer.

10.3 Resultant bidder stake in target

When a contractual offer lapses, any tendered acceptances also lapse. The bidder will therefore be left only with shares it has acquired through purchases (if any). Its stake will usually be less than 30 per cent of the target. However if, as a result of purchases, it was forced to make a Rule 9 offer which failed, a bidder could be left with a stake of 30 per cent or more.

10.4 Disposal of target securities

Once the offer has lapsed, the bidder is no longer subject to the Code restriction on disposing of target securities (Rule 4.2) and can therefore sell them freely (subject to insider dealing restrictions). If it decides to retain all or some of the shares acquired through stakebuilding, the degree of influence it can exert over the target will clearly depend on the size of its stake.

10.5 Code restrictions preventing immediate launch of new offer

Whatever the size of the bidder's stake in the target, its continued presence on the shareholder register may be a source of concern to the target, particularly if the target does not know what the bidder's intentions are. However, under the Rules of the Code, the bidder cannot launch a new offer within 12 months of its original offer lapsing unless the new offer (a) is recommended; (b) follows an announcement of a competing offer or (c) (in circumstances where the original offer lapsed by reason of a competition reference) follows the giving of clearance by the relevant competition authority. In that same 12 months, it cannot acquire further interests in target shares if it would then become obliged by Rule 9 to make another offer. Therefore, if it has an interest carrying less than 30 per cent of the voting rights of the target, it cannot acquire any further interest in target shares taking it to 30 per cent or more. If it has between 30 and 50 per cent it cannot acquire any further interest in target shares at all.

The intention of these restrictions is to prevent the target board from being endlessly under siege by the failed bidder, a situation which could be harmful to the interests of the target's business and hence its shareholders.

10.6 Expiry of Code restrictions on new offer

Once 12 months have elapsed, a bidder is free to make another offer. Rule 9 continues to apply and the bidder will be forced to make an offer if it takes its stake from below 30 per cent to 30 per cent or more or if it has between 30 and 50 per cent and it increases its percentage interest.

11. MBOs and similar transactions

11.1	Conflict of interest	82
11.2	Independent committee	82
11.3	Independent advice	82
11.4	Provision of information in the initial phase	82
11.5	Special deals with favourable conditions	84
11.6	Board's views	85

The expression "leveraged buy-out" is used to describe a transaction involving a special purpose company (usually a private equity financed bid vehicle) acquiring a target. Where the leveraged buy-out is being made in conjunction with some of the existing target management (referred to as a management buy-out (MBO)), a number of Code issues arise.

11.1 Conflict of interest

The Code provides that if an offer is an MBO or similar transaction, a director of the target will normally be regarded as having a conflict of interest where it is intended that he should have any continuing role (whether in an executive or non-executive capacity) in either the bidder or target in the event the offer is successful (Note 4 on Rule 25.1). In any event, there is likely to be a conflict between the duties a director owes to the target and those owed to the bidder.

Directors of the target who have a potential conflict should disclose full details of the conflict to the board of the target as soon as they are aware of it.

11.2 Independent committee

Given this conflict of interest, it is necessary for a committee to be formed of all of the directors of the target who will not have a continuing role in the event of the offer being successful (the Independent Committee) which will be responsible for the conduct of the target in response to the offer and which will need to decide, after taking independent advice, whether the proposal should be recommended to shareholders.

The Independent Committee should be formed as soon as the possibility of a take private transaction has been raised with the target board.

11.3 Independent advice

The target board must obtain competent independent advice on an actual or potential offer and to make known to its shareholders the substance of such advice (see Rule 3.1). Particular emphasis is placed on the importance of the requirement for competent independent advice in cases where the offer is an MBO or similar transaction (Note 1 on Rule 3.1). In such cases, it is particularly important that the independence of the adviser is beyond question. Furthermore, the responsibility borne by the adviser is considerable and, for this reason, the Code requires that the board of the target should appoint an independent adviser as soon as possible after it becomes aware of the possibility that an offer may be made.

11.4 Provision of information in the initial phase

An initial problem which arises in all MBOs and similar transactions is to decide what information the management team can give to the actual or potential debt and equity financiers of the transaction.

11.4.1 The duty of confidentiality

The problem arises because every director and employee of a company has a duty of confidentiality imposed upon him. He is not permitted to disclose any information about the business or affairs of the company except in the ordinary course of the company's business. This does not apply to information which is not confidential (i.e. information which could be obtained from another source) provided, of course, that the source did not receive it on a confidential basis. Insider dealing restrictions will also prevent the disclosure of non-public price sensitive information otherwise than in the proper performance of a person's duties.

It is clear that assisting with, arranging, promoting or financing an MBO or similar transaction would not fall within the definition of the ordinary course of the company's business. Although the duty of confidentiality is on the directors of the target, equity and debt providers and bidder directors should be aware of these restrictions in order that they do not encourage target directors to breach their duties and that they do not become recipients of confidential information that has been provided in breach of a duty of confidentiality.

11.4.2 Information provided to financiers

Management of any company is free to talk to financiers about the idea of putting together an MBO of the company or similar transaction. The mere discussion of the idea does not itself breach confidentiality. Publicly available information such as published brochures can be made available as part of such discussions.

The duty of confidentiality will be breached if management gives information about the company, such as management accounts and details of current trading, which is not publicly available. Similarly, projections and values of assets cannot be given and site visits should not be permitted.

11.4.3 Waiver of the duty of confidentiality

The consent of the Independent Committee should be sought to permit disclosure of confidential information. The consent should be given following a resolution of the Independent Committee and should not be sought just from one of the independent directors. Full details of the information to be disclosed and the purpose of that disclosure should be made to the Independent Committee, otherwise the consent may be ineffective. The consent should be in writing and should be obtained as early as possible and certainly before any confidential information is provided.

11.4.4 Equality of information

All information made available to a bidder must also be made available on request to any other bidder or potential bidder, whether welcome or not (Rule 20.2). In the case of an MBO or similar transaction this includes any information that the target has made available to any financiers or potential financiers of the bidder (whether debt or equity) and includes information generated by management of the target acting in such capacity. It may be difficult to determine whether information was provided

by a member of the management team in his capacity as a participant in the offer or as a director of the target. The management team should identify what they believe to be company information as opposed to information generated in their own time and otherwise than in their capacity as management of the target. The Panel has the final decision on whether or not a document or piece of information is disclosable under Rule 20.2. Therefore, if there is any possibility of another bid, care must be exercised in deciding what information is to be given to the financiers of a potential offer.

The management team is expected to liaise with the Independent Committee and its advisers in assembling information which is provided to the financiers of the potential offer (see Note 3 on Rule 20.2).

There is a separate and specific obligation that the potential bidder in an MBO or similar transaction must, on request, provide the Independent Committee or its advisers with all information (irrespective of the capacity in which it is generated) which has been furnished to potential financiers including information on the target developed by or with the assistance of management for the purpose of the transaction, for example, projections and business models prepared by the management or the private equity house (Rule 20.3). Due diligence reports prepared by professional advisers are also likely to be disclosable under Rule 20.3. Such information would not however need to be made available to competing bidders. The Panel should be consulted in cases of doubt.

11.5 Special deals with favourable conditions

As mentioned in sections 5.3.3 and 7.5, a bidder may not make any arrangements with shareholders or persons otherwise interested in voting shares either during an offer or when one is reasonably in contemplation if there are favourable conditions attached which are not extended to all shareholders (Rule 16). Due to their involvement in a proposed transaction the members of the management team may be offered, and decide to subscribe for, an equity interest in the bidder. If so, and if they are currently a shareholder, or are otherwise interested in voting shares, in the target (as is invariably the case), such an arrangement would amount to a prima facie breach of the principle of equivalent treatment of shareholders. However, the Panel may be prepared to consent to such an arrangement (Note 4 on Rule 16). As a condition to granting such consent, the Panel will require such arrangements to be approved by independent target shareholders voting on a poll at a general meeting. The financial advisers of the target will be required to confirm in the bid document that they consider the arrangements with target management (and any other incentivisation arrangements for target management, for example, appointment to the bidder board) to be fair and reasonable in the context of the offer so far as other shareholders of the target are concerned.

The Panel will be concerned to see that the members of the management team take the risks as well as the benefits associated with any shares for which they subscribe in the bidder. Thus any leaver provisions in the articles of association of the bidder which guarantee the shareholder the original issue price should be avoided.

Special deals should not be extended beyond the management team (e.g. to family members) without the prior consent of the Panel.

Details of the arrangements with management must be fully disclosed in the bid document.

11.6 Board's views

As mentioned above, the Code provides that a director participating in an MBO or similar transaction will normally be regarded as having a conflict of interest where it is intended that he should have any continuing role. Where a director has a conflict of interest, he should not normally be joined with the remainder of the board in the expression of its views on the offer required to be made by Rule 25.1 (Note 3 on Rule 25.1), such expression being given only by the directors forming the Independent Committee.

Depending on the circumstances, a director who has a conflict of interest may be required to make the responsibility statement required by Rule 19.2 in respect of information relating to the target but any such statement should be appropriately amended to make it clear he does not accept responsibility for the views of the board on the offer.

Glossary

acting in concert/concert parties – see section 2.7

AIM – Alternative Investment Market

associate – see section 7.7.8

Code – the Takeover Code

commencement of offer period – date of announcement of a proposed or possible offer (with or without terms)

Court meeting – see section 3.1.2

CREST – an electronic, paperless share settlement system

Disclosure and Transparency Rules or DTRs – the Disclosure Rules and Transparency Rules made by the FSA which, among other things, govern the dissemination of regulatory information to the market and impose dealing disclosure requirements

EA 2002 – the Enterprise Act 2002 described in section 4.4

ECMR – EC Merger Regulation described in section 4.2

EEA – European Economic Area

EU – European Union

First closing date (Day 21) – see section 8.6.1

FSA – Financial Services Authority

FSMA – Financial Services and Markets Act 2000 (as amended)

Irrevocable undertakings and letters of intent – see section 5.5.1

Listing Rules – the Listing Rules made by the FSA

MBO – management buy out

offer period – the period from the time an announcement is made of a proposed or possible offer (with or without terms) until the first closing date or, if this is later, the date when the offer becomes or is declared unconditional as to acceptances or lapses

offer unconditional as to acceptances – see section 9.1

offer wholly unconditional – see section 9.2

Official List – the list maintained by the FSA of securities which are traded on the London Stock Exchange's main market

OFT – the UK Office of Fair Trading

Panel – the Panel on Takeovers and Mergers (see section 1.1.3)

Prospectus Rules – the Prospectus Rules made by the FSA setting out the circumstances in which a prospectus is required or where an equivalent document can be prepared in its place as well as the form and content requirements for a prospectus or equivalent document

Regulatory Information Service – a regulatory information service authorised by the FSA to receive and disseminate regulatory information

Rule 2.5 announcement – bidder's announcement of a firm intention to make an offer under Rule 2.5 of the Code (see sections 2.1.5 and 7.2)

Rule 3 adviser – see section 8.1.1

Rule 9 mandatory offer – see sections 5.3.1 and 6.2

Rule 16 special deals – see sections 7.5 and 11.5

scheme of arrangement – see section 3

squeeze-out notice – see section 9.3.4

Takeovers Directive – the EU Takeovers Directive (2004/25/EC)

Index

The index is cross-referred to section numbers rather than pages.

Acceptances
offer unconditional as to 9.1
calculation of level of acceptances 9.1.2
deadline for declaring 9.1.1
minimum 14-day period following 9.1.3
withdrawal rights 8.6.5
Acting in concert
defined 2.7.1
implications 2.7.3
presumptions 2.7.2
Advertisements
making a bid 7.1.10
Announcements
circulation to shareholders 7.2.4
holding 2.1.4
no intention to bid statement 2.1.6
possible offer 2.1.4
pre-conditional 7.2.1
responsibility for making 2.1.3
Rule 2.5 (firm intention to make offer) 2.1.5, 7.2, 7.3.1
Asset valuations
information in bid document 7.1.5, 8.3.4

Bank finance
pre-bid planning 2.5.3
Bid defence manual
purpose 8.1.2
Bid document
additional conditions 7.3.7
bid documentation offence 7.3.4
contents 7.3.3
mutual conditions 7.3.8
offeree protection conditions 7.3.8
overseas resident shareholders 7.3.12
posting 7.3.1
principal documents on takeovers 7.3.2
subjective conditions 7.3.9
Bid protection
measures 2.4.6
Bid structure
contractual offer 2.6.2
dual holding company structure 2.6.3
"Newco" structure 2.6.3
scheme of arrangement 2.6.1
Boards of directors
changes in 8.4.3
collective responsibility of 2.2.2
management buy-outs, views regarding 11.6
target, approaching
method of approach 2.4.3
recommended or hostile takeovers 2.4.1
shareholders' decision 2.4.4
subsequent recommendations 2.4.5
timing of approach 2.4.2
target, removing
compensation for loss of office 9.4.3
forceful removal of directors, hostile bids 9.4.2
resignation of board 9.4.1
Break fees
description 2.4.6

Cash confirmation
description 2.5.5
Cash or cash alternative offers
description 2.5.2
City Code on Takeovers and Mergers *see* **Takeover Code**
"Cold shoulder" principle
Code enforcement 1.1.8
Companies Act 1985
reduction of capital 3.2.1
Companies Act 2006
bank finance 2.5.3
bid documentation offence 7.3.4, 8.3.2
disclosure obligations 5.4.2
schemes of arrangement 3.1.1
statutory and regulatory provisions affecting takeovers 1.2

Compensation for loss of office
removal of target board 9.4.3
Competition authorities
investigation by 4.1.1
Competition Commission
clearance from 5.2.3
reference to 4.3.5
term of offer 7.3.6
Competition issues
clearance prior to completion of takeover 4.1.4
disclosure of board and shareholder documents when seeking merger clearance 4.1.5
ECMR *see* EC Merger Regulation (ECMR)
effect of competition regulations on bid timetable 4.4.1
effect on bid timetable
if takeover a 'relevant merger situation' 4.4.2
takovers falling under jurisdiction of another national competition authority 4.4.3
Enterprise Act *see* Enterprise Act 2002, UK regime
"one-stop shop" principle 4.1.3
restrictions on stakebuilding activities 5.2.3
"substantial lessening of competition" test 4.3.4
target defence tactic 4.1.2
term of offer 7.3.6
Completion of acquisition
cancelling target's listing 9.5
competition clearance prior to 4.1.4
target board, removing
compensation for loss of office 9.4.3
forceful removal of directors, hostile bids 9.4.2
resignation of board 9.4.1
Compulsory acquisition *see* **Squeeze-out of minority**
Concentrations
Community dimension 4.2.1, 4.2.2
Concert parties
defined 2.7.1
implications of acting in concert 2.7.3
Confidentiality
breach of duty 11.4.2
management buy-outs 11.4.1, 11.4.3
pre-bid secrecy 2.1.1
standstill undertakings 2.3.2
waiver of duty 11.4.3
Conflict of interest
management buy-outs 11.1
Consideration
forms of 2.5.1
impact of stakebuilding activities on bid terms 5.3.2
posting to accepting shareholders 9.2.2
Contractual offers
60 day limit 3.1.5
acquiring minority on
implementation of statutory procedure 9.3.3
procedural steps 9.3.4
right of minority shareholders to be bought out 9.3.5
statutory procedure, squeeze-out of minority 9.3.2
tactics on hostile bid to trigger acceptances 9.3.7
untraced shareholders 9.3.1
lapse of 10.1
structure 2.3.2
Control
absolute 6.1.3
acquisitions up to but not including 30 per cent 6.1.1
Code whitewashes 6.4
legal 6.1.2
mandatory bids *see* Mandatory offers (Rule 9)
Criminal Justice Act 1993
insider dealing 5.2.1

Defence
bid defence manual 8.1.2
bidder increasing offer price 8.6.2
board changes 8.4.3
continued, by target 8.6.3
deadline for release of new information by target 8.6.4
defence document
communication of rejection of offer 8.3.1
contents 8.3.2
financial information on target 8.3.4
formal wording 8.3.3
standards of care 8.1.4
defensive tactics 8.1.3
directors' duties 8.2.2, 8.5.1
frustrating action 8.4
minimum period for offer to remain open 8.6.1
standards of care, documentation 8.1.4
target board deliberations 8.2.1
target response to bid 8.1.1
variations to directors' service contracts/pension scheme arrangements 8.4.3
withdrawal of acceptances 8.6.5
Directors
compensation for loss of office 9.4.3
forceful removal of, hostile bids 9.4.2
pension scheme arrangements, variations to 8.4.3
service contracts, changes to 8.4.3
Directors' duties
on agreeing to recommend offer 8.2.2
in general 8.5
Disclosure and Transparency Rules (DTRs)
announcements to market 2.3.3
disclosure on pre-bid stakebuilding 5.4.1
Disclosure obligations
bidder requirements under Listing Rules 5.4.3
clarification of intentions 5.4.6
Companies Act 2006 5.4.2
Disclosure and Transparency Rules (DTRs) *see* Disclosure and Transparency Rules (DTRs)
obligation to announce possible offer 5.4.5
offer period triggering 5.4.4
"put up or shut up" requirement 5.4.6
Rule 2.5 announcement (firm intention to make offer) 7.2.3

share dealing during course of bid 7.7.7
Takeover Code requirements 5.4.4, 5.4.5, 5.4.6
Documentation
bid document *see* Bid document
contractual offer 2.6.2
defence-related
communication of rejection of offer 8.3.1
contents of defence document 8.3.2
financial information on target 8.3.4
formal wording 8.3.3
standards of care 8.1.4
scheme of arrangement 3.1.6

EC Merger Regulation (ECMR)
competition issues regulation, effect on bid timetable 4.4.1
concentrations having community dimension, application to reform 4.2.1
European Commission's reference to national competition authorities 4.2.3
investigations 4.2.6
lapse of offer 4.2.7
national/supra-national jurisdiction 4.1.3
sanctions 4.2.8
thresholds 4.2.2
calculation 4.2.4
timing of notification 4.2.5
ECMR *see* **EC Merger Regulation (ECMR)**
Employee share schemes
Code treatment 7.4.3
other than share option schemes 7.4.4
scheme rules applicable on a takeover 7.4.2
share option schemes 7.4.1
Enforcement
Panel 1.1.8
Enterprise Act 2002, UK regime
application and thresholds 4.3.1
clearance 4.3.3
Competition Commission, reference to 4.3.5
competition restriction 5.2.3
informal advice 4.3.6
lapse of offer 4.3.7
OFT procedure 4.3.2
"substantial lessening of competition" test 4.3.4
European Commission
ECMR 4.2.1
investigations 4.2.6
national or supra-national jurisdiction 4.1.3
notifications to 4.2.5
reference to national competition authorities and vice versa 4.2.3
sanctions 4.2.8
Exclusivity arrangements
bid protection measures 2.4.6

Financial assistance
background 2.5.4
Financial promotions
restriction and exemption 7.1.8
Financial Services and Markets Act 2000
financial promotion regime 7.1.8
making a bid 7.1.6
market abuse 5.2.2
Financial Services Authority (FSA)
on enforcement of Code 1.1.8
Fireside chat (informal advice)
description 4.3.6
Frustrating action
prohibition on, 8.4
FSMA 2000 *see* **Financial Services and Markets Act 2000**

Hart Scott Rodino Antitrust Improvements Act 1976
competition clearance prior to takeover 4.1.4
Hearings Committee
appeals against decisions of 1.1.6
functions 1.1.5
Holding announcement
description 2.1.4
Hostile bids
acceptance, tactics to trigger 9.3.7
appointment of board committee 2.2.1
approaching target board 2.4.1
availability of target information 2.3.3
bid defence manual 8.1.2
bid defence tactics 4.1.2, 8.1.3, 8.4
defence document 8.3
defensive measures and directors' duties 8.5
directors, forceful removal of 9.4.2
target shareholder withdrawal rights 8.6.5
deadline for release of new information by target 8.6.4

Independent advice
Rule 3 adviser 2.2.3, 8.1.1, 11.3
Independent Committee
description 11.2
equality of information 11.4.4
waiver of confidentiality 11.4.3
Information
confidentiality 2.3.2, 11.4.1
waiver of duty 11.4.3
dealings in target securities 2.3.4
dissemination of 7.1.11
equality of 2.3.1, 11.4.4
hostile bids 2.3.3
making a bid 7.1.9
management buy-outs 11.4
supply of 2.3.1, 2.3.2
Insider dealing
restrictions on stakebuilding activities 5.2.1
share dealing during course of bid 7.7.6

Investigations
by competition authorities 4.1.1
Competition Commission 4.3.2
European Commission 4.1.3, 4.2.6
Irrevocable undertakings
soliciting shareholder support 5.5

Lapse of offer
ECMR 4.2.7
Enterprise Act 2002 4.3.7
Letters of intent
soliciting shareholder support 5.5
Listing Rules
bidder requirements 5.4.3
shareholder approval on significant stakebuilding 5.2.5
standards of accuracy 7.1.6
Long-term incentive plans (LTIPs)
scheme rules applicable on a takeover 7.4.2
share option schemes 7.4.1
LTIPs *see* **Long-term incentive plan (LTIPs)**

Making a bid
announcing *see* Announcements
bid document *see* Bid document
commencement of offer timetable 7.1.3
directors' duties 7.1.6
dissemination of information 7.1.11
documents for bidder's own shareholders/employees
bid document/prospectus etc 7.6.1
circular 7.6.2
financial promotion regime 7.1.8
formal offer 7.1.1
misrepresentation 7.1.6
special deals
general prohibition 7.5.1
management buy-outs/other exceptions 7.5.2
standards of care and responsibility statements 7.1.4
sufficient information 7.1.9
see also Offers *and* Schemes of arrangement
Management buy-outs *see* **MBOs (management buy-outs)**
Mandatory offers (Rule 9)
30 per cent threshold 6.2.1
applicable during voluntary offer 6.2.6
disadvantages 6.2.5
impact of stakebuilding activities on bid terms 5.3.1
mandatory offer trigger 6.2.2
structure of bid 6.2.3
terms of bid 6.2.4
Market abuse
restrictions on stakebuilding activities 5.2.2
share dealing during course of bid 7.7.6
MBOs (management buy-outs)
boards' views 11.6
conflict of interest 11.1
independent advice 11.3
Independent Committee 11.2
information provision, initial phase
confidentiality 11.4.1
equality of information 11.4.4
financiers, information provided to 11.4.2
waiver of duty of confidentiality 11.4.3
special deals with favourable conditions 7.5.2, 11.5
Merger benefits statements
description 7.1.5
Merger of equals
mutual conditions 7.3.8
Minimum offer price
impact of stakebuilding activities on bid terms 5.3.2
"Moral hazard" provisions
pensions legislation 1.3

"Newco" structure
bid structure 2.6.3
No intention to bid statement
announcements 2.1.6

Offer document *see* **Bid document**
Offer
cash or cash alternative 2.5.2
contractual *see* Contractual offers
declaring unconditional as to acceptances
minimum 14-day period following 9.1.3
disclosure obligations, offer period triggering 5.4.4
firm intention to make *see* Rule 2.5 announcement (firm intention to make offer)
formal 7.1.1
going wholly unconditional
fulfilment of remaining conditions 9.2.1
posting of consideration to accepting shareholders 9.2.2
lapse of
ECMR 4.2.7
Enterprise Act 2002, UK regime 4.3.7
making a bid *see* Making a bid
mandatory *see* Mandatory offers (Rule 9)
minimum offer price, stakebuilding 5.3.2
partial offer 6.3
possible offer 2.1.4
obligation to announce 5.4.5
timetable, commencement 7.1.3
unconditional as to acceptances
calculation of level of acceptances 9.1.2
deadline for declaring 9.1.1
unsuccessful *see* Unsuccessful bid, consequences
wholly unconditional 9.2
OFT (Office of Fair Trading)
jurisdiction 4.1.3
procedure 4.3.2
"One-stop shop" principle
competition issues 4.1.3

Panel Executive
functions 1.1.4
timely consultation with 1.1.10

Panel on Takeovers and Mergers
enforcement of Code 1.1.8
interpretation of Code, General Principles and Rules 1.1.9
membership 1.1.3
policing bid withdrawals 7.3.10
purpose 1.1.3
Partial offers
description 6.3
Pensions legislation
impact on takeovers 1.3
Pensions Regulator
functions 1.3
Pre-bid planning
acting in concert *see* Acting in concert
announcements *see* Announcements
bank finance 2.5.3
bid structures 2.6
board committee, appointment 2.2.1
cash confirmation 2.5.5
cash or cash alternative offer 2.5.2
collective responsibility of boards of directors 2.2.2
consideration, forms of 2.5.1
financial assistance 2.5.4
information *see* Information
no intention to bid statement 2.1.6
obtaining information on target 2.3.1
professional advisers 2.2.3
secrecy *see* Secrecy
target board, approaching *see* Target board, approaching
Pre-conditional announcements
description 7.2.1
Professional advisers
description 2.2.3
Profit forecasts
description 7.1.5
financial information on target 8.3.4
Prospectus Rules
standards of accuracy 7.1.6
requirement to prepare a prospectus 7.3.11
takeover exemption in 7.3.11

Regulatory Information Service
disclosure through 5.4.1
Responsibility statements
bid documentation 7.1.4
Rule 2.5 announcement (firm intention to make offer)
circulation to shareholders 7.2.4
consequences of making 7.2.2
disclosure obligations 2.1.5, 7.2.3
formal offer 7.1.1
posting of bid document 7.3.1
Rule 9 offers *see* **Mandatory offers (Rule 9)**
Rumour
secrecy 2.1.2

Sanctions
ECMR 4.2.8
Schemes of arrangement
advantages 2.6.1
bid structure 2.6.1
cancellation scheme 3.2.1
court-convened meetings 3.1.2
documentation 3.1.6
hybrid scheme 3.2.3
lapse of 10.2
process 3.1.2
statutory procedure 1.2
switching implementation method 3.1.4
and Takeover Code 1.1.1
timetable 3.1.5
transfer scheme 3.2.2
see also Bid document
Scheme document *see* **Bid document**
Secrecy
pre-bid 2.1.1
rumour and speculation, consequences 2.1.2
untoward share price movement, consequences 2.1.2
see also Announcements
Share dealing during course of bid
"associate", definition 7.7.8
consequences 7.7.4
disclosure obligations 7.7.7
insider dealing and market abuse 7.7.6
mandatory offer triggered during offer 7.7.2
prohibition on bidder disposal of target securities 7.7.5
prohibition on share purchases by target's financial adviser/broker 7.7.9
restrictions imposed on bidder share purchases 7.7.1
timing of share purchases 7.7.3
Share option schemes
employee share schemes 7.4.1
Shared jurisdiction
regulatory framework 1.1.2
Shareholders
circulation of bid to 7.2.4
decisions of, approaching target board 2.4.4
minority, right to be bought out 9.3.5
overseas resident 7.3.12
posting of consideration to 9.2.2
soliciting support 5.5
untraced 9.3.1
Special deals
general prohibition 7.5.1, 11.5
management buy-outs 7.5.2, 11.5
Squeeze-out of minority
stakebuilding activities, impact on bid terms 5.3.4
statutory procedure 9.3.2
unavailable if 90 per cent acceptance not received 9.3.6

Stake in target, acquiring before bid
disclosure obligations 5.4
impact of stakebuilding activities on bid terms 5.3
restrictions on stakebuilding activities 5.2
soliciting shareholder support 5.5
stakebuilding, consequences 5.1.2
tactical advantages 5.1.1
Standards of care
defence-related documents 8.1.4
making a bid 7.1.4
Standstill undertaking
description 2.3.2

Takeover Appeal Board
functions 1.1.6
Takeover Code
enforcement 1.1.8
General Principles 1.1.9
responsibility for compliance with 1.1.8
scope of application 1.1.1
spirit and letter 1.1.9
Takeover Panel *see* **Panel on Takeovers and Mergers**
Takeovers Directive
overseas resident shareholders 7.3.12
shared jurisdiction arrangements 1.1.2
Target board, approaching
method of approach 2.4.3
recommended or hostile takeovers 2.4.1
shareholders' decision 2.4.4
subsequent recommendation 2.4.5
timing of approach 2.4.2
Target board, removing
compensation for loss of office 9.4.3
forceful removal of directors, hostile bids 9.4.2
resignation of board 9.4.1
Target defence tactics
competition reference 4.1.2, 8.5.2
defensive measures 8.4, 8.5
frustrating action 8.4
Target securities
dealings in 2.3.4
disposal 10.4
see also Stake in target, acquiring before bid *and* Share dealing during course of bid
Thresholds
ECMR 4.1.3, 4.2.2
calculation 4.2.4
Enterprise Act 2002 4.3.1
Squeeze out 9.3.2

Unsuccessful bid, consequences
Code restrictions preventing immediate launch of new offer 10.5
disposal of target securities 10.4
expiry of Code restrictions on new offer 10.6
lapse of contractual offer 10.1
lapse of scheme 10.2
resultant bidder stake in target 10.3

Untoward share price movement
secrecy 2.1.2
White knight
description 8.5.2
Whitewash
Code whitewash 6.4
financial assistance whitewash 2.5.4
Withdrawal of acceptances
rights of 8.6.5

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