

# SALANS' COMPANY LAW UPDATE

## TAKEOVERS OF PUBLIC COMPANIES

May 2009



The current financial crisis has witnessed a fall in the market capitalisations of many companies whose shares are admitted to trading on the Main Market of the London Stock Exchange or on AIM. This has resulted in opportunities for cash-rich investors to acquire such companies in the hope of making a return on their investment when the markets recover. Potential targets may also wish to take steps to protect against an unwanted offer. This article seeks to provide an overview of the regulations and procedures that should be borne in mind by both bidders and target companies.

### LAUNCHING A TAKEOVER OFFER

#### REGULATORY FRAMEWORK

The Disclosure and Transparency Rules, the Code of Market Conduct, the Criminal Justice Act and the Financial Services and Markets Act apply to takeovers of all companies, irrespective of their place of incorporation, that are admitted to the Main Market or AIM. The City Code on Takeovers and Mergers (the '**Code**') and the Companies Act 2006 ('**2006 Act**'), or similar company legislation, may also apply where the target company is incorporated in the UK, the Channel Islands or the Isle of Man.

This article focuses on takeovers of companies admitted to the Main Market or AIM. However, many of the points raised are also relevant to companies admitted to other markets, such as the Specialist Fund Market and the PLUS Market.

#### THE CODE

The Code is issued by the Panel on Takeovers and Mergers (the '**Panel**')

and is designed to ensure fair and equal treatment of all shareholders during a takeover. The Code applies to all offers for companies admitted to the Main Market and AIM which have their registered office in the UK, the Channel Islands or the Isle of Man and (in the case of companies admitted to AIM) are considered to have their place of central management and control in one of these jurisdictions. It may also apply to: (i) other public companies; and (ii) private companies whose shares have been listed, or who have been required to file a prospectus, in the ten year period before an offer is launched.

The Code sets out a formal procedure for making an offer. It also details circumstances in which a person is required to make an offer for all of a company's shares, called a 'mandatory offer'. For example, a 'mandatory offer' must be made where: (i) a person's total holding reaches 30% or more of the company's voting shares; or (ii) a person holding more than 30% but less than 50% of a company's voting shares acquires additional shares. When calculating whether this rule has



been triggered, any shares in the company held by any other shareholders acting in concert with the relevant person will be included.

There is an increasing number of companies admitted to the Main Market or AIM to which the Code does not apply as they are not incorporated (or managed, in the case of companies admitted to AIM) in a relevant jurisdiction. However, many such companies see the Code's formal procedures as providing them with a level of protection against takeover bids. It is not uncommon for such companies to have incorporated provisions of the Code into their articles of association, or equivalent constitutional documents. When launching a takeover of such a company, provisions equivalent to those of the Code may have to be followed although the Panel would not oversee the takeover procedure.

#### STAKE-BUILDING AND ANNOUNCEMENTS

A bidder will often build a stake in the target before launching a takeover offer. Care must be taken where the Code applies as, for example: (i) if more than 29.9% of the shares of the target are acquired then a 'mandatory offer' must immediately be made; and (ii) the offer price per share cannot be less than the highest price paid by the

bidder in the three month period before launching the takeover offer.

As a potential takeover offer is price-sensitive it is important that, subject to any disclosure requirements (see below), absolute secrecy is maintained throughout any stake-building exercise and before any approach is made to the target. The bidder should limit the number of its internal and external teams to those who 'need to know' and should use a codename for the target in all communications to preserve its anonymity. The Code requires that a public announcement be made in certain circumstances, including when:

- ❖ the target is the subject of rumours of an imminent offer;
- ❖ there is an untoward movement in its share price either: (i) following an approach; or (ii) before an approach has been made if it is likely that the bidder's actions have led to the movement;
- ❖ a firm intention to make an offer is notified to the target's board; and
- ❖ changes are made to the terms of an offer, or its conditions are met.

There are detailed rules regulating the content of any announcement. An announcement should not be made without taking advice from the bidder's



professional advisers. The Panel must also be consulted on any statements that are to be released before a firm intention to make an offer has been notified to the target.

#### STRUCTURING THE OFFER

Under the Code an offer must first be communicated to the target's board of directors or to its advisers. The identity of the bidder must be disclosed at the outset. The bidder must be able to satisfy the board and the Panel that it is in a position to implement the offer in full. This will include its ability to meet any cash element of the consideration.

The majority of take-over bids are 'recommended' or 'agreed' bids, meaning that they have the support of the target's board. This makes the conduct of the offer easier and will enable the bidder to access more detailed due diligence information. Where the board does not support the offer it is known as a 'hostile bid'. In such circumstances a public relations battle often ensues between the bidder and the target, and the bidder can only rely on information in the public domain for its due diligence (see the comments on 'insider trading' below).

Once the intention to make an offer has been announced, a formal offer document containing its terms and conditions must be posted, usually within twenty-eight days. If the target's

board supports the offer then a letter from the board recommending that the shareholders accept the offer will usually accompany the offer document. The only condition that is permitted by the Code to be attached to a 'mandatory offer' is that the offer will not complete unless there are sufficient acceptances to enable the bidder to acquire over 50% of the shares. Where the offer is not 'mandatory' the bidder can include additional conditions, such as a higher threshold of acceptances and the approval of any relevant competition authorities.

#### OTHER CONSIDERATIONS

##### MARKET ABUSE

Market abuse is defined as certain behaviour by a company or individual, relating to securities admitted to a relevant market (including the Main Market or AIM), including insider trading, the improper disclosure of inside information, the misuse of information or market distortion. The sanctions for breaching the rules include an unlimited fine, public censure and the payment of compensation to victims. There are also criminal offences of market manipulation and making misleading statements. The market abuse regime applies regardless of whether the Code governs the takeover offer.



The Financial Services Authority's ('FSA') Code of Market Conduct provides guidance in this area. It states that behaviour based on inside information relating to a target in the context of a takeover bid does not of itself amount to market abuse. This is helpful in that it allows a bidder, for example, to undertake due diligence on the target, seek irrevocable undertakings from shareholders and make arrangements for the placing or underwriting of securities that are to be offered as consideration without fear of breaching the rules.

#### INSIDER TRADING

It is a criminal offence for an individual who holds 'inside information' to deal, or encourage others to deal, in securities when in possession of inside information relating to those securities. 'Inside information' is specific information relating to a company's securities that is not public and that would be likely to have a significant effect on the price of those securities if made public. The insider trading regime applies regardless of whether the Code governs the takeover offer.

The penalties for committing insider trading include fines and imprisonment. However, insider trading may also constitute the civil offence of market abuse and the FSA often has the option to pursue either claim.

These provisions make it difficult for a bidder to conduct due diligence on a target company during a stake-building exercise. If a bidder receives material due diligence information then it will not be able to acquire further shares in the target without breaching the insider trading regime unless: (i) the information is disclosed to the market by the target; or (ii) the bidder announces an offer for all of the target's shares. If the target's board is hostile to an offer then it is unlikely to release the information and the bidder will only be able to acquire further shares by announcing an offer.

#### DISCLOSURE OF DEALINGS

In addition to the restrictions on dealing in securities imposed by the market abuse and insider trading regimes, once a takeover offer has been publicly announced:

- ❖ any dealings in 1% or more of any securities of the target must be disclosed to the Panel; and
- ❖ neither the bidder, nor any associate of the target, may deal in the target's securities without the Panel's consent.

Acquirers of shares admitted to the Main Market or AIM should also keep in mind their ongoing disclosure obligations under the Disclosure and



**Transparency Rules.** A person who acquires or is entitled to acquire control over more than 3% of the voting rights in a UK listed company, whether by a single or a number of acquisitions, must usually disclose its interest to the company. A further disclosure must usually be made for each subsequent 1% acquired or sold. The thresholds for the disclosure of holdings in a non-UK company (where its shares are admitted to trading on a UK regulated market and the UK is its home member state) are 5%, 10%, 15%, 20%, 25%, 30%, 50% and 75%.

#### **SQUEEZE OUT**

A bidder which has, through a takeover offer to all shareholders, acquired 90% or more of the issued shares of a target incorporated in the UK has the right under the 2006 Act to compulsorily acquire the shares of the remaining shareholders. Similarly, such minority shareholders have the right to require the bidder to acquire their shares. Any shares held by the bidder at the time that it posts the offer document are excluded for the purposes of this calculation.

#### **DEFENDING A TAKEOVER OFFER**

##### **FRUSTRATING ACTION**

The Code prevents a target's board from taking defensive action that would

frustrate an imminent bid unless its shareholders have approved the action by ordinary resolution. This prohibition extends to issuing new shares, issuing any options or similar securities and/or disposing of any material assets. The payment of a dividend by a target company outside of its usual timetable may also constitute frustrating action. If there is any doubt as to whether a course of action would be in breach of this prohibition then the board should consult with the Panel in advance of the action being taken.

##### **POISON PILLS**

Public companies may wish to structure their business in such a way as to deter any future bid. For example, a company may wish to include change of control clauses in its key contracts or grant weighted voting or subscription rights. Such practices, referred to as 'poison pills', are common in the US but are harder to enforce in the UK.

Any attempt to adopt a 'poison pill' when an offer for the company is imminent is likely to be prevented by the Code rules on frustrating action. In addition both the Listing Authority and representative bodies of the main UK institutional shareholders (such as the Association of British Insurers and National Association of Pension Funds) have resisted the types of weighted share structures adopted in



the US. As a result, even where a bid is not imminent, a 'poison pill' share structure is unlikely to be approved by the company's shareholders. Directors must also be aware of their fiduciary duty, now enshrined in the 2006 Act, to act within their powers. Case law suggests that the issue of new shares to defend against a bid may not be a proper exercise of a director's powers.

#### PERMITTED ACTION

There are a number of steps that a target can take to defend against an unwanted takeover offer. These include the following:

- ❖ The target's board will want to convince shareholders that the offer undervalues the target and that the shareholders would be better rewarded by keeping their shares. The board should prepare such arguments, supported by relevant financial information, as early as possible and may want to release information in support of its belief in the target's future prospects. Where the bidder is offering its own shares as consideration the board may also wish to examine the bidder's financial strength. Any information that is released in defence of an offer must be properly verified.
- ❖ The target should consider obtaining and publishing written

statements from key shareholders who do not wish to accept the offer. Such statements may help to convince other shareholders not to accept the offer. Where the Code applies the statements will need to be approved by the Panel.

- ❖ The board can try to encourage a competing offer from a third party (called a 'white knight') in order to ensure the best price for the target's shares. In doing so the directors will be accepting that a takeover is inevitable. Alternatively the board can try to encourage a third party (here called a 'white squire') to acquire a block of shares large enough to prevent the original offer from succeeding.
- ❖ Where an offer is subject to the approval of relevant competition authorities, the target can seek to provide information to the authorities demonstrating that the takeover would have an anticompetitive effect on the market. Any such information must be accurate and must not seek to mislead the authorities.
- ❖ There are a number of mechanisms by which the target can try to encourage shareholders to reject an offer by committing to, for example, a bonus issue of preference shares entitling their holders to a fixed dividend. Such



mechanisms tend to be complex and may only be appropriate in certain cases.

In taking any of the above steps the directors of a UK incorporated target must ensure that they are acting in the best interests of the target, otherwise they will be in breach of their fiduciary duties. Similar considerations may also apply to target companies that are not incorporated in the UK.

## OUR EXPERIENCE

Salans is experienced in acting both for companies whose shares are listed on the Main Market and on AIM and for bidders seeking to acquire such

companies. In recent months we have seen an increase in enquiries from entrepreneurs interested in listed companies whose market capitalisation is perceived to have fallen below the real value of the company.

We have recently advised Black Sea Global Properties Limited on its successful takeover of Fabian Romania Limited, a Jersey company admitted to AIM and the Bermuda Stock Exchange which focuses on real estate in Romania. The offer, which was subject to the Code, followed an initial stake-building exercise and took the form of a mandatory recommended cash offer. The offer valued the target at approximately €50.8 million.

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