PCP 2010/1 – Profit forecasts, asset valuations and merger benefit statements

Response of the Takeovers Joint Working Party of the City of London Law Society Company Law Sub-Committee and the Law Society of England and Wales' Standing Committee on Company Law

Below are the views of the Takeovers Joint Working Party of the City of London Law Society Company Law Sub-Committee and the Law Society of England and Wales' Standing Committee on Company Law (the "Working Party") on PCP 2010/1.

Q1 Do you agree with the Code Committee's proposals for the provision of exemptions from the obligation to report on a profit forecast published in the normal course of a company's business in the circumstances described above?

The Working Party agrees in principle with the Code Committee's proposals, recognising that it is largely a codification of existing practice.

As well as profit forecasts in the normal course, we feel the Panel should be able to exempt profit forecasts which whilst not published in the normal course are also not published in connection with or to support the offer, but in connection with another transaction. We suspect that this would need to be dealt with on a case-by-case basis and will only occur in a small number of cases.

The Working Party feels that the one-month cut-off is somewhat arbitrary but notes that the Panel has (and agrees that the Panel needs) flexibility beyond that time limit, so accepts this approach. An alternative approach may be to cast the one-month cut-off as a (rebuttable) presumption so that a forecast made more than one month before the offer period will be presumed to be in the normal course whereas a forecast made after that cut-off will be presumed to be in connection with the offer.

We are not clear if the Panel's intention is that it will be harder to get an exemption under Rule 28.3(d) than Rule 28.3(e) (using the numbering on page 62 of the PCP). From the wording, it appears that it will be. If this is the intention, it would be helpful if the Panel could confirm that this is the case and explain the reasoning behind it. It is not clear to us why there should be a difference.

If it is the case that it will be harder to get an exemption under (d) than (e), the Working Party believes that paragraph (e) of Rule 28.3 (as set out on page 62 of the PCP) should be stated to apply where the forecast is made "in the one month prior to the commencement of or during the offer period " (rather than "only during the offer period"): a profit forecast made in the one month prior to the start of the offer period should be treated in the same way as a forecast made in the offer period and be exempt from reporting requirements if it meets the other criteria in (c).

Q2 Do you agree that the Code should provide for dispensations from the requirement for an opinion of a named independent valuer to support a normal course asset valuation in the circumstances set out above?

The Working Party agrees with the Code Committee's proposals but suggests that the word "normally" be inserted between "will" and "be" in Rule 29.1(d).

Q3 Do you agree that Rule 28.6(c) should be amended as proposed to provide an exemption from reporting for an unaudited profit estimate for a completed period reported in an interim management statement?

The Working Party agrees with the Code Committee's proposals.

Q4 Do you agree that Rule 28.6(c) should be amended as described to provide an exemption from reporting for unaudited statements of interim results reported by companies admitted to trading on AIM or PLUS?

The Working Party agrees with the Code Committee's proposals.

Q5 Do you agree that the Code should treat profit forecasts and estimates for part of a business in the same way as forecasts for the whole of the business?

The Working Party agrees with the principle of the Code Committee's proposals. However we have concerns that (a) there is no materiality test here, and (b) a wider range of exemptions will be required in respect of parts of a business. For example, many UK listed companies have listed subsidiaries or associates, or joint ventures or investments which in each case disclose trading performance ahead of the listed company subject to the Code, or give earnings guidance. Whilst the principles applied to the listed company itself as regards exceptions would obviously also apply to parts of the business, we are concerned that they will be insufficient, in particular in the context of hostile offers. In the absence of a broader set of exemptions we envisage that there will frequently be arguments about reporting requirements in hostile bids on parts of the business, which (a) are not directly controlled by the parent offeror/ offeree, (b) are not material, (c) are simply following normal practice, e.g. publishing an interim management statement, when the burden of reporting becomes disproportionate given relative size. We believe this needs to be addressed by the Code Committee.

Q6 Do you agree with the proposals to expand the application of the rules on merger benefits statements to cover other statements as described above and to introduce a new definition of a “quantified effects statement”?

The Working Party agrees in principle with the Code Committee's proposals. We do however feel that the new Rule 28.10 should start with the words "Except with the consent of the Panel…." to make it clear that the Panel has discretion to exempt a particular statement which does not fall within the provisions of Rule 28.10 (b). This is particularly

important as the requirements are being moved from a note (i.e. Note 8 to Rule 19.1) into a Rule.

Q7 Do you agree with the proposals relating to the circumstances in which reports may be required on "quantified effects statements"?

See our comments on Q6 above.

Q8 Do you agree that Rule 28.3(c) should be deleted?

The Working Party agrees with the Code Committee's proposals.

Q9 Do you agree with the proposed amendment of Rule 28.6(a)?

The Working Party agrees with the Code Committee's proposals.

Q10 Do you agree with the proposed new Rule 28.11 and Rule 29.7?

The Working Party supports the Code Committee's desire to avoid the use by offerors and offerees of analysts' forecasts and valuations as a means of leaking their own forecasts and valuations. We believe that is already caught by Note 4 to Rule 19.1.

As explained in the PCP, the main change in practice from the proposed Rule change is to clarify that parties to an offer may not refer to analyst consensus numbers, even where they have not adjusted those numbers or altered their presentation, or sought to imply their use as a proxy for the company's own forecasts.

The concern we have is whether by seeking to catch all references to analyst views, boards of offerees (in particular) are becoming overly constrained from even debating the merits of an offer. At the heart of any hostile offer is the question of whether its terms represent good value. That turns on, amongst others, key issues like valuations, earnings multiples, future earnings expectations and potential and quality of management. We are concerned that a broad constraint on any reference to analyst views will simply lead to offerors and offerees who do not seek to imply that their own expectations are consistent with a particular analyst's views, either (a) inevitably breaching the Code in their discussions with investors, or (b) being unable to have an informed debate with investors.

As indicated, we do see a difference between valid debate using analyst views as an objective support for value negotiation, on the one hand, and a party seeking to leak its own expectations for its performance by picking particular analyst numbers, on the other.

Accordingly, we are concerned that what seems like a logical extension of Note 4 to Rule 19.1, designed to support the objective of that Rule, will in fact assist hostile bidders by further limiting potential for value arguments to be debated. The UK focus on forecasts and projections is not shared in certain other major jurisdictions and a further extension of that regime seems to us potentially to risk missing the point of what is at issue and therefore needs debating in the context of a bid. The reporting rules in practice preclude forecasts of

any significant use being debated in the context of a UK takeover, when the performance expectations and growth potential of a target are often the main issue in point, and consensus analyst numbers are the only external metric available to assist that debate.

Q11 Do you agree that Rules 28.7 and 24.2 should be amended as proposed?

The Working Party agrees with the Code Committee's proposals.

Q12 Do you agree with the proposed replacement of the words "in exceptional circumstances" in Rule 29.1(d) (the proposed new Rule 29.1(f)) by the words "with the Panel's consent"?

The Working Party agrees with the Code Committee's proposals.

Q13 Do you agree with the proposed consequential amendments to Rules 28.1, 28.6(g), 32.1 and Appendix 1.4(o)?

The Working Party agrees with the Code Committee's proposals.