3 March 2006

IMPLEMENTATION OF THE TAKEOVERS DIRECTIVE

Response to PCP 2005/5 by the Joint Working Party on Takeovers of the Law Society of England and Wales' Standing Committee on Company Law and the City of London Law Society's Company Law Sub-Committee.

Overall we support the Takeover Panel's approach of attempting to minimise the changes to the Takeover Code in order to implement the EU Takeovers Directive (**"Directive"**). We have set out below a number of detailed comments and suggestions.

We are aware that it is intended by the DTI that the Directive be implemented by Regulations made under section 2(2) of the European Communities Act 1972. We have already expressed to you and to the DTI our regret that, for an interim period, such Regulations will mean the Code has two different legal bases: one statutory and one not. In a number of cases this may cause confusion as to how the Code (and in particular the new statutory powers) should operate, as it is far from clear which provisions of the Code can be said to be within the 2(2) rule making power and which cannot.

Q1. Do you agree with the provisions of the new Introduction to the Code, or have any comments on these provisions?

As mentioned above, we support the approach that the Panel has taken in attempting, generally, to keep the number of required changes to a minimum and we appreciate that many of the provisions in the proposed new Introduction to the Code reproduce text contained in the current Introduction and General Principles. However, we are conscious that it is proposed that most of these provisions will be elevated into Rules and, as a result, the Panel will have statutory enforcement powers in respect of them. Against this backdrop, although we appreciate that the Panel's approach of making minimal changes has the benefit of maintaining wording that has been in the Code for some time and is understood in the market, we are concerned to ensure that the language of the Code is as clear as it can be within the new statutory framework. Our comments on the new Introduction are set out below. We believe that the statutory basis for the Code means it is appropriate to clarify certain provisions.

Paragraph 3 – Companies, transactions and persons subject to the Code

3(a)(iii) The definition "information and company law matters" would be clearer if it was amended to read "employee information and company law matters".

3(a)(iii) The requirement for a company referred to in paragraphs (c)(II) or (III) to notify which Panel is to regulate it is unclear as to whether that is at the outset of a transaction or on the first date of admission to trading . The latter is required under the Directive.

3(b) We support the deletion of reverse takeovers from the list of regulated transactions: the previous inclusion was misleading. The revised wording is an improvement.

3(b) We suggest the Panel should make it clear that the Panel will determine what is an offer for "non-voting non-equity capital": this is a constant source of confusion as regards shares intended to be within this exclusion but having voting rights in certain circumstances or equity rights in remote circumstances, in the latter case commonly

included to make preference shares equity share capital for Companies Act purposes (but where such categorisation is inappropriate under the Code). We suggest the Code definition of voting rights should apply.

3(e) Code protection may be lost in other ways: a company could convert into a European company and then move its jurisdiction. Alternatively under the new Cross-Border Mergers Directive, it can merge into a company in another jurisdiction. If the EU implements a Directive on the Transfer of Registered Seat (as contemplated) this will be even simpler. We suggest the clause contemplates other bases of loss of Code protection too.

3(f) We note that much of the wording in this paragraph on "Code responsibilities and obligations" has been replicated from the current General Principles and it is our understanding that paragraph 3(f) does not aim to change the current position on Code responsibilities. However, words which have been comfortably accepted in a non-statutory context, with the Panel's recognition of the spirit of the Code, seem to us to warrant, in a few cases, greater precision in the new regime, to avoid being applied literally.

We believe that there is some uncertainty amongst financial advisers as to the implications of the second paragraph and how financial advisers are required to act either before their appointment is clear or in the event a client refuses to follow their advice. This may be best dealt with as a separate issue outside the implementation of the Directive.

In the third paragraph, we understand that the wording "and other entities to which the Code applies" is not intended to apply to advisers (which are dealt with in the preceding paragraph). This needs to be clarified here to avoid any implication that advisers are required to ensure that they give their employees generally appropriate training on the Code.

In addition, we would suggest the following changes "…ensure <u>where appropriate</u> that their directors and employees ~~receive appropriate training in respect of the Code~~ <u>are aware of their obligations under the Code</u>…". These amendments clarify that companies do not have to demonstrate formal "training" of directors and employees as such; it is sufficient that the relevant people are aware of their obligations. In practice this would usually be complied with by companies and their advisers producing a memorandum of "dos and don'ts" for directors and employees. The insertion of the words "where appropriate" makes clear that not all plcs need to ensure that directors and, especially employees, are aware of their obligations at all times; it will be sufficient for them to focus on this when the company is engaged in a matter potentially subject to the Code.

In the fourth paragraph, the words "and their advisers" should be deleted from the first sentence as advisers are not under a duty to act in the best interests of the shareholders of their client. We realise this wording is currently in the introduction to the General Principles, but it is wrong and too broad and under statutory rules inappropriate to stand as such.

On the same principle, we are concerned with the reference, in the fourth paragraph, to directors' duties to act in the interests of shareholders. This is inappropriate for statutory rules, as it is not correct: the Panel is aware directors' duties are to the relevant company. In discharging duties to companies, directors must consider the interests of shareholders. This is spelt out in the new Company Law Reform Bill: rules

created by a statutory body should not assert a different duty, in a way that could be accepted from a non-statutory body.

Paragraph 4 – The Panel and its Committees

(b) We do not agree that amendments should be capable of being made, without consultation, to the Code where the Code Committee believes it does not materially alter the intended effect of the provision in question. There is too great scope for changes without consultation under this power. There have already been a number of cases where the Panel has (by way of analogy) issued a Practice Statement which the Panel believes does not change its current practice but which practitioners believe does so.

(c) We suggest that the title "Hearings Committee" does not sound suitably important: it may demean what has historically been regarded as the "full Panel". That, in turn, may encourage appeals as standard.

Paragraph 7 – Hearings Committee

7(e) We are concerned that the proposed new automatic right of appeal against decisions of the Hearings Committee to the Takeover Appeal Board will lead to a large increase in the number of appeals being heard with no testing of whether the appeal has any merits. We are not convinced this is wise, unless clearly needed for human rights reasons (and if so, why was it not already there?). We consider that the Panel's proposal in its January 2005 Explanatory Paper to allow appeals on the grant of leave either from the Hearings Committee or the Takeover Appeal Board would be preferable and suspect it would satisfy the requirement in clause 626(3) of the Company Law Reform Bill requiring a right of appeal.

Paragraph 9(a) -Providing information and assistance to the Panel and the Panel's powers to require documents and information

9(a) In the first paragraph, the words in brackets impose unqualified correction and up-dating obligations. However the third paragraph is (rightly we suggest) more measured in the up-dating obligation. We suggest that the words ", where potentially still relevant to the Panel" be inserted within the brackets after the words already included in the first paragraph, to avoid a disproportionate and uncertain up-dating obligation, potentially long after a bid has ended and the facts have become irrelevant.

Paragraph 10 – Enforcing the Code

10(a) The wording in this section follows clause 630 of the Bill. We have previously pointed out to the DTI our concerns with the drafting of clause 630 which we consider might lead an aggrieved party to argue that it gives it a mechanism for obtaining a judicial hearing on a disagreement it has on a Panel ruling. We note that the DTI has stated that the aim is to provide a mechanism for the Panel to apply to court to enforce a Panel rule-based requirement or a Panel request for documents and information and that the DTI envisages that the enforcing court would not consider it appropriate to rehear substantively the matter or examine the issues giving rise to the rule (or, as the case may be, the request for documents or information). However, a number of our members, though understanding the definitional approach adopted, consider that the wording in clause 630(i)(a) "if…the court is satisfied that there is a reasonable likelihood that a person will contravene a rule based requirement… the court may

make any order it thinks fit …." and the equivalent wording in clause 630(i)(b) could be interpreted more broadly than intended by an aggrieved party and more importantly by the courts. The definition of "rule-based requirement" in clause 630(4) means a requirement imposed by or under rules; the section could be read as the court needing to be satisfied that a person has contravened a rule, or that there is a reasonable likelihood that the person will contravene a rule, which could be interpreted as requiring a substantive rehearing of the issue leading to the Panel's ruling i.e. the court would consider the underlying breach of rule, not focus primarily on the breach or the threatened breach of a ruling.

We recognise that the courts will always have the ability to consider the validity of a ruling, on the basis that even if clause 630 referred to a "ruling" or "decision" it would have to be a ruling by the Panel in accordance with the law and the relevant rules. However, since we believe "rule based requirement" is expressed to apply to requirements under "rules", i.e. the underlying requirement not the requirement of the "ruling", substantial litigation re-testing the decisions of the Panel is a real risk. It would, it seems to us, be highly regrettable for some unintended confusion in the wording of this section to lead, post the statutory regime, to the introduction of a litigation culture in relation to Panel rulings. We recognise that enforcement under clause 630 is on the application of the Panel, but our concern is that those subject to rulings by the Panel will refuse to comply pending the hearing of an application by the Panel to exercise its powers under this section: the tone of the draft clause suggests an opportunity for the Panel's ruling to be re-opened and re-considered: i.e. the Panel must demonstrate a "rule" breach, not just a "ruling" breach. We believe that our concern can be largely addressed by relatively minor amendments to the drafting: for example, at the end of the definition of "rule-based requirement" the inclusion of the words "whether pursuant to a decision or ruling of the Panel or otherwise".

Q2. Do you agree with the proposals for amendments to the General Principles, Definitions and the Rules to implement the Directive?

We have a small number of comments. (The paragraph numbers below refer to the paragraphs in the consultation paper not Rule numbers.)

Paragraph 5.3.2 - Disclosure of Concert Parties

We agree with the Panel that too broad disclosure of concert parties is burdensome and without value. We believe that it is still too burdensome to require all connected advisers to be disclosed: this is in danger of catching accountants, actuaries, PR advisers, benefits consultants, lawyers and others who could be said to be advising on the offer. We suggest listing principal financial advisers should suffice, if those with shares are caught anyway.

Paragraph 5.6 - Making documents and information available to shareholders, employee representatives and employees)

We have a number of concerns with the proposed new Rule 30.3.

- We do not consider that the Directive requires bidders and targets to ensure that documentation and information be sent to shareholders and employees who are located outside of the EEA. Article 8.2 of the Directive specifically states that "Member States shall provide for the disclosure of all information

and documents …. in such manner as to ensure that they are both readily and promptly available to the holders of securities at least *in those Member States on the regulated markets of which the offeree company securities are admitted to trading…*" This obligation is clear.

We note that the Code Committee believes that it is arguable that the information provisions apply to all shareholders irrespective of the specific wording in Article 8.2 because of the wording in Article 5.1 and Article 3.1 (a). However Article 5.1 addresses a different point to that addressed by the information provisions; it is concerned that an offer be made to all holders of target securities. Regardless of whether documentation is sent to overseas shareholders, the offer can still be made to those shareholders on the same terms as it is made to the other shareholders by means of a newspaper advertisement and so we do not see why Article 5.1 should be read together with Article 8.2. Article 3.1(a) requires that all holders of target shares must be afforded equivalent treatment. It is our view that where a target shareholder has put himself in a position whereby he cannot be afforded equivalent treatment by the target, for example, because he lives in a country with onerous securities laws, then the General Principle should be interpreted in the light of that fact.

For these reasons we consider that extending Rule 30.3 to shareholders and employees outside the EEA is undesirable. This is an extremely important issue: the costs of this proposed new rule will be massive and appear to have been completely ignored in framing the proposals. It would be wholly disproportionate to require companies to go to the additional costs of addressing all overseas securities law issues as a consequence of different regulatory circumstances which arise from decisions outside a company's own control: i.e. which investors in which overseas jurisdictions choose to buy shares in the company?

- If, on reflection, the Panel still considers it necessary to apply Rule 30.3 to non-EEA shareholders and employees, we consider that the wording of the proposed derogation set out in the Note should be amended.

  In practice, the jurisdictions we are most likely to be considering are jurisdictions such as the US and Australia. On a cash offer where a UK target has US shareholders, the bidder may decide not to comply with the provisions of the US Exchange Act and so, to avoid triggering US jurisdiction, must ensure that no offering materials are sent into the US. Taking this approach will ensure that the bidder minimises its risk under US anti-fraud and anti-manipulation laws in respect of the offering materials. An alternative for the bidder if US shareholders in the target hold less than 10% is to make the information available to the US shareholders and rely on the Tier 1 exemption which will exempt the bidder from a number of requirements under the US tender offer rules but will still subject it to a greater risk of liability under US laws.

  The derogation as currently framed will mean that a bidder for a target which has more than 3% of its shareholders in the US will be required to rely on the Tier 1 exemption and subject itself to the greater risk of liability because it will be required to send the offering materials into the US. This, combined with

the fact that it is often difficult to ascertain exactly how many US shareholders there are in the target at any given time, may involve a significant cost for a potential bidder. On a securities exchange offer there will also be concerns about requirements to register under the US Securities Act (which in some cases will preclude transactions from being feasible, where currently they can proceed).

In addition, if a bidder has decided not to comply with US laws and comes within the terms of the derogation in respect of US shareholders but is required to make the information available to employees in the US (because more than 3% of the target group's employees are based there) there is a significant risk that the US shareholders may obtain the materials and that US jurisdiction will be triggered.

We consider that many of the difficulties described above could be avoided by deleting the percentage threshold in the derogation. The 3% threshold is clearly arbitrary and we believe neither appropriate nor required under the Directive. Even a higher level such as 10% seems to us unnecessary and seeking to address issues the Directive does not in fact require to be addressed. There is significant experience already from the US Tier 1 exemption as regards the difficulties of identifying the location of shareholders in any event. It is important to bear in mind that UK offers are made to US shareholders, anyway, just not inside the US itself. This has not caused problems in practice, whereas the new proposal will have (as explained) serious negative consequences in terms of, in particular, securities exchange offers and generally on costs.

In addition, we consider that the following amendments would make the derogation clearer

"may result in a significant risk of civil, regulatory or particularly criminal exposure for the offeror or the offeree company <u>if the information or documentation is sent to or made available to shareholders or employees in that jurisdiction without any amendment</u>, and unless they can avoid that exposure by making minor amendments to the information……. "

Paragraph 6.5 – Timetable of offers

On the proposed amendment to Rule 31.7 (Time for fulfilment of all other conditions) it would be clearer if it read "The Panel's consent will not normally ~~only~~ be granted <u>unless</u> ~~is~~ the outstanding condition….."

Paragraph 8.2.4

The new note on Rules 13.1 and 13.3 (page 76 of the consultation document) sets out the circumstances in which an offer can be made subject to a condition relating to financing, and, in particular, the new paragraph (a)(ii) refers to the situation where the offer is being finances by an issue of new securities which are to be admitted to the Official List or to trading on AIM, where an appropriate listing or admission to trading condition will be permitted.

We do not understand why the condition is limited to an offeror listed on the Official List or on AIM, and does not extend to offerors listed elsewhere in the world whether within or outside the EU. We suggest (a)(ii) to be amended as follows:

> "where the new securities are to be admitted to listing or trading on a stock exchange on which the offeror's securities are (or are to be) listed or traded".