The City of London Law Society

The Law Society

PCP 2021/1: Miscellaneous Code amendments

Response of the Company Law Committees of the City of London Law Society and Law Society

4 February 2022

Introduction

1. The views set out in this response have been prepared by a Joint Working Party of the Company Law Committees of the City of London Law Society (**CLLS**) and the Law Society of England and Wales (the **Law Society**).

2. The CLLS represents approximately 17,000 City lawyers through individual and corporate membership, including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multijurisdictional legal issues. The CLLS responds to a variety of consultations on issues of importance to its members through its 19 specialist committees.

3. The Law Society is the professional body for solicitors in England and Wales, representing over 170,000 registered legal practitioners. It represents the profession to Parliament, Government and regulatory bodies in both the domestic and European arena and has a public interest in the reform of the law.

4. The Joint Working Party is made up of senior and specialist corporate lawyers from both the CLLS and the Law Society who have a particular focus on issues relating to takeovers.

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Response

Q1 Should the Code be amended as proposed so as to require a publicly identified potential offeror to announce any minimum level, or particular form, of consideration it is obliged to offer to offeree company shareholders?

5. It seems that any such disclosure will only be required in a relatively small minority of bids (particularly in the case of possible offer announcements that commence an offer period) and we have certain practical concerns about the proposed revisions to the Code, in particular in the context of leak announcements which may happen at a very preliminary stage in the process, when there is a significant uncertainty about whether an offer will be forthcoming at all (and, if so, on what terms) and when the bidder itself may not have full visibility on the interests and dealings of its concert parties and the value of an immediate announcement is therefore limited. This will impact on the obligations as to confidentiality and the operation of the "rule of 6" in the very early stages of a potential offer (see paragraph 7 below) and will present significant logistical challenges in gathering all concert party information prior to the first announcement (particularly if at the very early stages of an offer) which seem disproportionate and at odds with other key principles of the Code. Indeed, it is already common to see firm offer announcements which start an offer period to declare concert party interests not to be known.

6. Should the Panel decide to proceed with a formal requirement for bidders to disclose any obligations to offer a particular level or form of consideration, in our view this could be better dealt with by disclosure in the bidder's Opening Position Disclosure as this would alleviate some of the practical issues discussed below and strike a more appropriate balance between speed and clarity.

7. Should the Panel decide to proceed with the proposed requirement to include information in a leak announcement we would make the following observations in relation to revised R2.4:

   - Paragraph 2.23 of the PCP notes that the new requirement in R2.4(c)(iii) and (iv) is not intended to apply to unnamed potential bidders. However the wording of R2.4(c) refers to any announcement which commences an offer period. While such an announcement would typically require naming of potential bidders this would not be the case in the context of a formal sales process. While N3 on R2.4 cross refers to N2 on R2.6 in relation to formal sales processes, this only deals with naming

and put up or shut up deadlines. We would suggest this is clarified either in the Notes on R2.4 or in N2 on R2.6.

- We assume that where an announcement commencing an offer period is made without the agreement or approval of a potential bidder, not only would the relevant bidder be required to make an announcement specifying the matters referred to in R2.4(c)(iii) and (iv) as soon as practicable, but the announcement by the target should also not include these items (as this is not information of which the target would be aware and where disclosure of inaccurate information could create false markets). It would be helpful if this could be clarified in N1.

- We assume that revised R2.4(c) would only require positive disclosure and would not require a negative statement to be made if there is no such obligation or arrangement but it would be helpful if this could be confirmed. Requiring a negative statement would be undesirable in our view given that in a significant majority of cases no positive disclosure would be necessary, such that requiring a negative statement would result in additional "boilerplate" disclosure.

- The PCP recognises that there may be circumstances where a debate is ongoing with the Panel about whether an obligation exists under R6 or R11 or about whether certain transactions should be disregarded. It may also be the case that a potential offeror is about to commence such a discussion when a relevant announcement obligation is triggered. If it is not possible for the issues in question to be resolved prior to announcement being made, we assume that it would need to be agreed on a case by case basis with the Panel what disclosure by the bidder it would be appropriate to include. This is likely to have an adverse impact on the ability of potential offerors to publish announcements at very short notice in response to rumour and speculation or untoward share price movements which would be to the detriment of the objectives of the parties to a potential offer being able to issue announcements promptly and ensuring the maintenance of an orderly market. These concerns would be alleviated to a large extent if disclosure were instead required in the bidder's Opening Position Disclosure as this would allow more time for such issues to be resolved before disclosure to the market is made.

- It would be helpful for the approach in N2 on R2.7 to be replicated in relation to R2.4, recognising that it is unlikely to be practicable (or indeed possible in light of the rule of six) for a bidder to have made enquiries of all of its concert parties prior to the announcement being made. Again, this issue would be alleviated if disclosure were instead required in the bidder's Opening Position Disclosure.

- We note that N6(b) and N6(c) on R8 have not been amended (although N2 on R2.4 which cross-refers to them has been deleted). This would mean that, in addition to any dealing arrangements with concert parties being disclosed in the leak announcement, such concert parties would also be required to make a separate announcement as soon as possible after commencement of the offer period. This would seem duplicative.

8. In relation to new R7.1, we note there seems to be some inconsistency between the final sentence of paragraph 2.26 of the PCP and the text of the revised note on that rule. We assume that the revised note reflects the correct position – i.e. that the application of the rule is limited to potential bidders (a) whose existence has been referred to in any announcement (whether publicly identified or not); or (b) which are participants in a formal sales process (regardless of whether they were a participant at the time at which the formal sales process was announced).

Q2 Should a mandatory offeror, and any person acting in concert with it, be restricted from acquiring additional interests in shares in the offeree company in the 14 days up to and including: (a) the unconditional date; and (b) the expiry of an acceptance condition invocation notice?

9. As a general rule, the Code does not restrict bidders from share buying but rather imposes consequences if they do so in certain circumstances. In our view, restrictions should only be imposed where this is necessary to address a clear mischief. In this context, we do not think that there is sufficient rationale for restricting mandatory bidders from share buying in the circumstances outlined in the PCP. Target company shareholders will be aware of the existing control position of the bidder and of the

possibility that this may increase in the period up to the closing date if market purchases can be made (particularly if the market price is below the offer price) and will be aware of any purchases by virtue of the market disclosures which need to be made. A bidder which ended up with less than 50% would need to make a further offer if it subsequently acquired a single additional share, would not have statutory control and the target would remain listed.

10. In the event that the Panel does proceed with the proposed changes, we would suggest a drafting amendment to R9.4. It would seem that R9.4(b) and (c) are referring to the same time period, and therefore it would arguably be clearer for the wording of the two limbs to be aligned – i.e. so that, rather than prohibiting a voluntary bidder from triggering R9 unless the offer "can remain open for acceptances for at least 14 days", R9.4(c) instead referred to a voluntary bidder not being permitted to trigger R9 in the 14 days up to and including the unconditional date or the expiry of an ACIN.

Q3 Should the new Note 5 on Rule 9.5 be introduced as proposed in order to clarify the application of the "look-back period" for determining the minimum price of a mandatory offer?

11. Yes – we agree with this proposal.

Q4 Should the test in limb (b) of Note 8 on Rule 9.1 be deleted such that the test in limb (a) would become the sole test for determining whether a chain principle offer is required, other than in exceptional circumstances?

12. We support the proposed deletion of limb (b) and welcome the move towards a more objective approach.

Q5 Should the threshold at which relative values would be considered to be "significant" for the purposes of the test currently set out in limb (a) of Note 8 on Rule 9.1 be reduced from 50% to 30%?

13. In essence the chain principle is designed to avoid shareholders losing out because there is a bid for, or substantive change of shareholder ownership of, the parent company, Company B, which is really a disguised bid for the underlying Code-governed company, Company C.

14. The extension of the chain principle beyond situations where the Code company represents 50% of the value, is a major and we think unhelpful change of philosophy. There is no logic to a 30% of value test save to provide a windfall benefit to shareholders who invested never expecting one (and an unexpected and potentially very significant cost to the ultimate shareholders of the parent Company B, who will receive less value from a bidder than they are currently entitled to expect). This conceptual change intervenes too extensively in indirect ownership matters.

15. Overall, we do not think the case has been adequately made out for the threshold to be lowered. There is no need for there to be a parallel between this threshold and the 30% threshold in Rule 9. The two tests have no connection, as under the chain principle the percentage is to do with economic relevance, not control.

16. In this context, we would also note that (a) in the Hong Kong Code on Takeovers and Mergers, the chain principle refers to a higher threshold than the current UK provisions (relative values of 60% or more) when assessing significance; and (b) under the Australian regime (which includes provisions similar in principle to the chain principle, albeit structured in a slightly different manner), in line with the current UK regime, relative values of 50% or more are normally regarded as the threshold for determining whether acquisition of a downstream company is a significant purpose of an upstream acquisition.

17. Overall, given the complexity of the issues surrounding the impact of the chain principle and the different circumstances in which chain principle bids can arise for consideration, we question whether the proposed change achieves a sufficiently worthwhile policy objective.

18. As a separate point, we suggest that the opportunity should be taken to clarify the position in relation to intra group reorganisations. The Panel has consistently and helpfully taken the view that simple intra-

group reorganisations above the level of Company B should not trigger chain principle bids. It seems to us that it would be helpful to include in a Note a comment to the effect that in normal circumstances intra-group reorganisations would not be caught. Another approach would be for the Code to make it clear that the Panel has discretion to grant a waiver.

Q6 Should Note 1 on Rules 35.1 and 35.2, Note 2 on Rule 2.5 and Note 2 on Rule 2.8 be amended as proposed in relation to the restrictions following the lapsing of an offer or a statement of no intention to bid?

19. Yes – we agree with these proposals.

20. However, in relation to section 6(f) of the PCP (duration of restricted periods under N2 on R2.5 and N2(d) on R2.8) we would make the following points:

- We note, where a potential bidder omits reservations from a possible offer announcement, this is likely to be for different reasons than a firm bidder making a no increase statement. In particular, it may be agreed to by the potential bidder as part of the process of obtaining access to due diligence on the target company - where this is the case, would the Panel consider modifying its approach?

- Paragraphs 6.28 – 6.29 of the PCP cover the application of the proposed restrictions in circumstances where terms are announced (without reservation) following an existing firm offer. We assume that the proposed restrictions would apply in the same way where the original terms were announced (without reservation) before a competing firm offer was made, but it would be helpful if the Panel could confirm the position.

Q7 Should the minor amendments to the Code set out in Section 7 of the PCP be adopted as proposed

21. We agree with these proposals but have certain drafting related points and points where further clarification would be helpful as set out below.

22. New N10 on interests in securities – we would suggest replacing the reference to "A bank" with "A person" as custodians will not always necessarily be banks. The reference to "in the normal course of its business" will ensure that only professional custodians are caught in any event.

23. In relation to R24.3(c) it would be helpful to confirm whether the Rule is only intended to capture ratings accorded to the bidder and target company or also to other members of their group. For example quite often ratings might be according to a financing subsidiary rather than the offeree company itself.

24. In relation to R32.1(b) and R32.6(b) we would suggest that rather than making documents available "at the same time" as publication of the offer document/response circular it would be more appropriate to refer to making them available "promptly" following publication.

25. Appendix 8 – we would suggest the minor drafting changes below. The reference in paragraph 2(c) "Auction Day 1" is potentially confusing as it implies that the auction process has continuing relevance whereas this would not be the case following a no increase statement. We would also query why in those circumstances the other bidder's offer should need to be announced in accordance with s3(a) rather than in the normal way by 5pm on the relevant day.

8.2(a): *Except with the consent of the Panel and subject to Section 2(c), the latest time by which….*

8.2 (c) *If a competing offeror makes a no increase statement either on the day prior to Day 46 or on Day 46 (before 5.00 pm), [the auction procedure will not commence and] the other competing offeror may announce a revised offer ~~on Auction Day 1 in accordance with Section 3(a)~~ by 5.00 pm on the business day immediately following Day 46*