Bloomberg
Law Reports®

September 5, 2011
Vol 3 No 9

UK Financial Services Law

The Cadbury Plc factory in Birmingham, UK
Credit: Wolfgang von Brauchitsch/Bloomberg News

UK Takeover Panel's Review of Certain Aspects of the Regulation of Takeover Bids

Contributed by Leon N. Ferera and Simon Kiff, Jones Day

Public Takeovers

After 18 months of debate, the Code Committee of the Panel on Takeovers and Mergers has published the final changes to be made to the City Code that will come into effect on 19 September. The changes have been made in light of the controversy sparked by Kraft's takeover of iconic British company Cadbury last year. Some fear that the changes could deter legitimate bidders, particularly those who rely on bank finance and those who rely on basic deal protection measures. p54

Conduct of Business

While both the UK and U.S. approaches to whistleblowing attempt to stamp out non-compliance, they diverge in their motivations and the degree of protection given to whistleblowers. p12

Contributed by Jeremy Cole, Daniel F. Shea, Lillian Tsu, Liam Naidoo and Roxanne Tingir, Hogan Lovells International LLP

Market Conduct

The U.S. Galleon convictions for insider dealing were secured with heavy reliance on the evidence obtained by wire tapes. What impact is this case likely to have on UK regulation - would the grant of wire tapping powers to the FSA be going one step too far? p50

Contributed by Robert Falkner, Reed Smith LLP

Commodities & Derivatives

By the end of 2012 the way derivatives markets work will change significantly. The details though of the EU's new rules under EMIR and MiFID are still to be drafted and many practical issues remain to be resolved. p3

Contributed by Ron Feldman and Neil Robson, Schulte Roth & Zabel International LLP

Corporate Governance

The European Commission has recently expressed concern that the "comply or explain" approach of many codes of conduct provides companies with a carte blanche for deviation. However, feedback shows strong support for the doctrine because it has a proven track record for promoting good governance. p20

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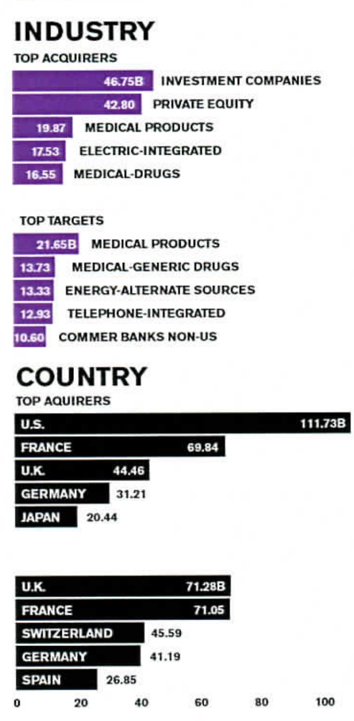
The Alternative Investment Fund Managers Directive came into force on 21 July 2011. Member States have until 22 July 2013 to implement the Directive into national Law. ESMA is currently consulting on the Directive's level two implementing measures before providing its advice to the Commission in November. p33

Contributed by Adrian Brown, Nabarro LLP

Recent Trends in International Takeover Activity

Date Range: 1/1/2011 - 8/2/2011



Source: Bloomberg L.P.

- **Settlement discount**: the FSA may apply a discount for early settlement (DEPP 6.5B.5G and 6.7). In view of Sir Ken's continued co-operation with the FSA and willingness to settle at an early stage, he qualified for a stage one discount to the tune of 30 percent. The penalty was therefore reduced to £210,000.

The FSA therefore imposed a total financial penalty of £210,000 on Sir Ken for breaching DTR 5.8.3R which was payable by 30 August 2011.

[1] Final Notice at para. 11.

[2] A shareholder for these purposes includes the both the legal and beneficial owners of the shares in question.

[3] FSA/PN/072/2011.

Public Takeovers

Offers

UK Takeover Panel's Review of Certain Aspects of the Regulation of Takeover Bids

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Contributed by Leon N. Ferera and Simon Kiff, Jones Day

The takeover of Cadbury Plc by Kraft Foods Inc. in early 2010 prompted widespread public discussion about the regulation of UK takeovers. Concern was expressed that it was too easy for a hostile offeror to obtain control of an offeree company and that the outcomes of takeovers, particularly hostile offers, were unduly influenced by the actions of short-term investors.

In June 2010, the Code Committee of the Panel on Takeovers and Mergers (Panel) issued a public consultation paper[1] containing suggestions for amendments to the City Code on Takeovers and Mergers (the City Code) to address these concerns.

The purpose of the proposed amendments was to:

- Reduce the tactical advantage obtained in recent times by hostile offerors and redress the balance in favour of the offeree company;
- Ensure greater account is taken of the position of persons affected by takeovers in addition to offeree company shareholders, most notably employees; and
- Increase transparency and improve the quality of disclosure.

The Code Committee has now published the results of the consultation and the consequent amendments to the City Code which will take effect on 19 September 2011.[2]

Key Changes

The key changes to be made to the City Code:

- Place greater restrictions on "virtual bids" and tighten up the City Code's "put up or shut up" regime;
- Prohibit inducement fees and other deal protection measures, except in very limited circumstances;
- Impose greater disclosure requirements on offerors; and
- Improve the quality of information made available to the target's employees and require bidders to make clear their future intentions for the target's business.

The takeover of Cadbury Plc by Kraft Foods Inc. in early 2010 prompted widespread public discussion about the regulation of UK takeovers

Naming Potential Offerors and Restriction of "Virtual Bids"

Much concern had been raised prior to the consultation about the ease with which potential offerors could destabilise target companies through supposedly phoney bidding wars. The package of new rules aims to put an end to this with the following measures:

- Following an approach, any leaks or other announcement by a target company commencing an offer period must name the potential offeror.
- Except with the Panel's consent, the named potential offeror must, within 28 days of first being named, either: 1) announce a firm intention to make an offer; 2) announce that it will not make an offer, in which case it will potentially be prevented from bidding for up to six months; or, 3) apply to the Panel jointly with the offeree for an extension. The Panel will take into account all relevant factors when considering whether to grant an extension, including the status of negotiations and the anticipated timetable for announcing a firm intention to make an offer.
- Any further potential offerors who come forward must also be identified in any announcement released by the target mentioning the existence of further interested parties. Such other parties will then be subject to the "put up or shut up regime" mentioned above. Potential

offerors whose interest is announced after the release of a firm offer announcement will not be subject to the 28 day deadline but will be required to "put up or shut up" in the later stages of the offer process.

The regime outlined above will not apply in the case of a controlled auction.

The consequences of these changes are wide ranging. The ability to extend the period is so uncertain that it cannot be factored into any sensible bid planning. In most cases the preparations, including due diligence, required to get to the stage of a cash confirmed firm intention announcement will take significantly longer than 28 days (and often several months), particularly where a lender is involved. There is therefore concern that 28 days will not be long enough for many bidders, particularly hostile bidders who are unlikely to benefit from an extension.

A number of respondents to the consultation argued that an offeror should be entitled to conduct a bid in secrecy before its due diligence confirms that a bid is worth pursuing. In particular, the British Private Equity and Venture Capital Association argued that to require an offeror to be named too early could result in an association of the offeror with "failed bids" when, in practice, the supposed offeror was only involved in initial due diligence. Potential offerors may also be able to manipulate the provisions by leaking information, resulting in an announcement being required naming any competing offers or forcing such offerors to withdraw and not re-bid for up to six months. All of these factors could discourage legitimate potential offerors from putting forward proposals that could benefit target shareholders and cause poorly performing boards not to be held to account for their actions.

Prohibition on Inducement Fees & Other Deal Protections

Inducement or break fees and other deal protections, such as non-solicitation undertakings, matching rights, undertakings by an offeree to inform the original offeror of an unsolicited approach and no information undertakings, will all be prohibited. Subject to the Panel's prior consent, this prohibition will not apply: 1) in the case of a controlled auction; 2) to a white knight bidder;[3] and, 3) to companies in financial distress. In each such case, inducement fees totalling no more than 1 percent of the value of the target calculated by reference to the offer price will be allowed. The prohibition on deal protections will not apply to undertakings to maintain the confidentiality of offeror information, not to solicit the offeror's customers or employees and to provide information necessary to satisfy offer conditions or obtain regulatory approvals.

Complex deal protection measures had become commonplace in recent years and there was concern that target boards had little choice but to accept them and that they had the effect of deterring other bidders. The reason for the prohibition, therefore, is to strengthen the offeree's position and to avoid a situation where competing offerors are deterred or offer less favourable terms. However, there is an argument that the prohibition on all but a very limited number of basic protections has gone too far in the other direction. Bidders have traditionally utilised inducement fees as protection against potentially wasted time and money spent on pursuing abortive transactions. The abolition of fees may be particularly damaging to private equity buyers who may have a limited ability to pay fees prior to drawing down from their fund to make an offer and may deter potential bidders from the risk of incurring potentially wasted costs. The abolition of non-solicitation undertakings might have a similar effect: potential bidders might be loath to act as stalking horses and spend time and money pursuing an offer only for the target to be able to solicit other bids at the same time.

Disclosure of Deal Fees

Under the new regime, both the bidder and the target will have to make a disclosure in the offer document regarding their respective deal fees. A breakdown will have to be provided for each adviser/ provider (*i.e.,* fees for investment bankers and brokers, legal advice, accounting advice, PR services and other professional services including consultants). Where fees have not already been paid, an estimate will have to be provided. Where any fee is variable between defined limits, a range must be given in respect of the aggregate fees and expenses and of the fees and expenses of each relevant category, setting out the expected maximum and minimum amounts payable. If an estimate for a particular category is exceeded by a material amount (an over-run of 10 percent or more will be material), the relevant party must notify the Panel who will then decide whether the increase should be made public.

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The Panel takes the view that increased transparency on fees will help lower offer-related costs and avoid situations where advisers charge high fees for advice that might not necessarily be in the best interests of their clients. While there is merit in this, having to provide an estimate might turn out to be challenging if the estimate has to cater for unexpected events. It could also be misleading if the estimate turns out to be too high or too low.

Increased Disclosure for Offerors

The amendments to the City Code will also increase the disclosure requirements for offerors in various ways.

First, all bidders will need to disclose details of their bid financing arrangements, including: the amounts being borrowed; all fees (*e.g.,* drawdown fees and commitment fees); repayment terms; interest rates; and, and key covenants. However, the Code Committee acknowledges that the amount of any potential increase in a facility (*i.e.,* "headroom") that the offeror might have agreed with its financing banks will be a matter of particular commercial sensitivity and will not have to be disclosed provided it is set out in a separate standalone document. Private equity firms and other leveraged buyers have expressed concern that this requirement may discourage many lenders from providing finance for takeover offers.

Secondly, a bidder will have to disclose certain additional financial information: the last two audited consolidated accounts (this will be required for all offers, not just securities offers as has been the case up to now in certain circumstances); a statement of the effect of full acceptance of the offer on its earnings, assets and liabilities;

credit ratings, summary details of any outlook, such as whether the long-term and/or short-term debt ratings were on "negative watch" and details of changes to the ratings and outlooks during the offer period, including reasons for those changes (offerees will have to disclose similar details); and, in the case of a securities-exchange offer, details of any significant change in its financial or trading position since the end of the last financial period for which either audited financial information or interim financial information has been published (or an appropriate negative statement).

Many questions have been raised about the merit of including details of ratings: they can be subjective, are not always reliable and numerous ratings agencies exist. It could be onerous to include the ratings given by all of them.

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Intentions for the Offeree & its Employees

Many of the changes to City Code seek to improve the quality of information made available with regard to the effect of an offer on employees of the target.

As was the case previously, a bidder will be required to state, amongst other things, its intentions with regard to the continued employment of target employees and management, its strategic plans for the target and its intentions regarding the future business of the target. However, if the bidder has none, it will now be required to make a negative statement. In addition, the Panel will enforce compliance with any statement of intention, or negative statement, regarding the target made by the offeror or the offeree for 12 months or such other period as the relevant party specifies, unless there has been a material change of circumstances.

This raises the question as to how an offeror which has not had an opportunity to undertake full due diligence will comply with the new regime. The Code Committee has stated that it recognises that the new requirement may lead to such statements of intention, and/or negative statements, being made subject to certain qualifications but considers that it is preferable for an offeror to make a detailed, albeit qualified, statement rather than a general unqualified one. It also acknowledges that it might be legitimate for a hostile offeror which has not had an opportunity to undertake full due diligence on the offeree company to state that it will undertake a review of the offeree company's business once it has obtained control of the company. However, the Code Committee believes that the offeror must have a fundamental business rationale for seeking to acquire the offeree company, which it should disclose as fully as possible. It also considers that statements of a general nature are unlikely to be acceptable in the context of a recommended offer where the offeror has had an opportunity to undertake full due diligence.

Targets will now also be required to remind employee representatives of their right to have their opinions on the offer appended to the target board's circular if they are received in good time prior to its publication. If not received in good time, target companies will need to disclose the opinion on their websites and announce their posting on their websites. The "reasonable" cost of funding any professional advice for obtaining the opinion will now be for the account of the target. Little guidance has been provided as to what are "reasonable" costs.

Conclusion

Some commentators have argued that it is not the role of the City Code or the Panel to encourage or impede the making of takeover offers, but rather to create an orderly framework within which takeover bids can be conducted. Nevertheless, it seems that there is a very real risk that some of the changes could deter legitimate bidders. This is particularly the case for those relying on bank finance and bidders, including many foreign bidders, who regard basic deal protection measures such as break fees and non-solicitation undertakings as a means of keeping target boards honest and as a pre-requisite to incurring the expense and accepting the distraction associated with an offer. It remains to be seen who will benefit from many of these changes.

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[1] Review of Certain Aspects of the Regulation of Takeover Bids – Code Committee Consultation Paper PCP2010/2 of 1 June 2010.

[2] Review of Certain Aspects of the Regulation of Takeover Bids – Code Committee Response Statement RS2011/1 of 21 July 2011.

[3] Where a hostile offer has already been announced and a preferred potential competing bidder (otherwise referred to as a white knight) subsequently emerges.