HOSTILE TENDER OFFERS
RETURN TO TENDER

Guy Morgan discusses the key legal and commercial issues associated with the planning and implementation of hostile tender offers.

Tender offers are most frequently used by listed companies in order to implement share buybacks. Indeed the Financial Conduct Authority's (FCA) Listing Rules require that, in certain circumstances, purchases by a premium-listed company of its own equity shares can only be by way of a tender offer (*see box "Share buybacks"*). However, it is less common to see a tender offer being used to acquire stakes in third-party companies.

This article examines the reasons why a party might make a tender offer for shares in a third-party company, the regulation of tender offers where the offeree company is subject to the Takeover Code (the Code) and the process for making tender offers.

WHAT IS A TENDER OFFER?

A tender offer is an offer to the shareholders of an offeree company to acquire interests typically representing less than 30% of the voting rights of that offeree. This is different to the position in the US, where a tender offer is what, in the UK, would be called a takeover.

Tender offers can be used to acquire an initial shareholding or to increase an existing shareholding in a company (*see box "Example tender offers"*).

All tender offers involve the shareholders being invited to sell or "tender" their shares to the offeror at either a fixed price or at a maximum price. Shareholders tender their shares by returning a tender application form within the period for which the offer is stated to be open.

REASONS FOR TENDER OFFERS

Tender offers to shareholders of third-party companies are relatively rare, not least because parties that are looking to acquire non-controlling stakes in listed companies will typically prefer to approach major shareholders privately through brokers and avoid the cost and public scrutiny that is inherent in a tender offer.

However, the ability to convey an offer to the entire shareholder base of a company, rather than just to major shareholders, combined with the relative simplicity of the tender offer process means that, in certain circumstances, tender offers can be an attractive option to consider. They are most commonly used by activist investors for whom the public nature of a tender offer can be appealing.

A tender offer is typically only used to acquire shares carrying less than 30% of the voting rights; that is, a non-controlling stake in the offeree company. By contrast, an ordinary takeover offer must be conditional on an offeror acquiring or agreeing to acquire shares carrying over 50% of the voting rights in the offeree.

In a tender offer, the transaction documents are generally less complex and there are usually fewer Code obligations than there are on a full or partial takeover offer. The flipside of this simplified structure is that the terms that may be attached to a tender offer are restricted (*see "Regulation of tender offers" below*).

Tender offers to acquire stakes in third-party companies are frequently hostile although, in theory, a tender offer can be recommended by the offeree's board.

REGULATION OF TENDER OFFERS

Tender offers for companies to which the Code applies are subject to the rules set out in Appendix 5 to the Code. Although the whole of the Code is expressed to apply to tender offers, in practice, few other rules of the Code are relevant to the making of a tender offer.

Consideration and price

A tender offer must be made for cash consideration, which may be at a fixed price or a maximum price:

- Under a fixed price tender, shareholders are offered the opportunity to sell some or all of their shares at a fixed price. The offeror company will set a limit on the maximum number of shares to be purchased.

- Under a maximum price tender offer, shareholders are invited to tender their shares at a price within a range of prices set by the offeror. The offeror sets the maximum aggregate amount that it is prepared to pay to shareholders. If the tender offer is oversubscribed, the so-called strike price will be the lowest price at which the number of shares sought is met and all shareholders that tender at or below the strike price will receive that price. If the tender offer is undersubscribed, all shareholders that tender will receive the maximum price, subject to the minimum acceptance condition being met.

Offeror shares, loan notes or contingent value rights may not be offered as consideration under a tender offer. This position can be compared with partial offers, which can be for consideration other than cash, although these offers are rare (*see box "Partial offers"*).

Share buybacks

A buyback is a purchase by a company of its own shares. A company may want to buy back its own shares to return surplus cash to shareholders, for example after a large disposal, to increase earnings per share, enhance share liquidity or provide an exit route for shareholders.

Under the Companies Act 2006, a company may buy back its shares either through an off-market purchase or a market purchase; that is, a purchase made on a recognised investment exchange, such as on the Main Market of the London Stock Exchange or AIM. A listed company will typically purchase its own shares on market, after making a regulatory information service announcement notifying the market of its intention to do so.

Some structures will also involve both off-market and market purchases as part of the share buyback. For example, B share schemes often use an intermediary to buy the shares on market. The company then buys the shares from the intermediary as an off-market purchase.

The Listing Rules require that purchases by a premium-listed company of 15% or more of any class of its own equity shares, excluding treasury shares, under a general shareholder authority, can only be by way of a tender offer (*Listing Rule (LR) 12.4.2*). When calculating whether a share buyback will exceed the 15% threshold:

- A series of buybacks made under a general authority to make market purchases must be aggregated when calculating whether the 15% threshold has been reached.

- Where the 15% threshold is reached, a tender offer is only required in relation to the buyback(s) taking the level to or above 15%. Therefore, a company can use a general market authority up to the 15% level, provided that shareholders have approved this level of market buyback, and then undertake a tender offer if it wishes to meet or exceed the 15% threshold.

- Buybacks that have been specifically approved by shareholders do not count towards the 15% threshold. While it is rare for a premium-listed company to seek approval for an off-market purchase, this type of buyback should not count towards the 15% threshold. A company could, therefore, make market purchases under a general authority up to 14.99% of its issued share capital and further off-market purchases from named shareholders (under a separate members' resolution) without needing to make a tender offer (*LR 12.4.3G*).

There are no Code restrictions on the price that may be offered on a tender offer, which may be at a premium or a discount to the prevailing market price.

Cash confirmation

There is no explicit Code requirement for an appropriate third party, such as the offeror's bank or financial adviser, to give a cash confirmation statement affirming that sufficient resources are available to the offeror to satisfy full acceptance of the tender offer.

In practice, however, it is common for a financial adviser or bank to carry out financial due diligence on the offeror and to require the issuance of a representation letter by the offeror to it, so as to satisfy itself as to the availability of sufficient funds to cover the maximum amount of consideration that may be payable under the tender offer.

This contrasts with the position on a full or partial takeover offer involving any element of cash consideration where the Code mandates that a formal cash confirmation statement must be given by an appropriate third party. If in giving such a cash confirmation, the cash confirmer is deemed not to have acted responsibly or not to have taken all reasonable steps to assure itself that the

Example tender offers

Date	Offeror	Offeree	Fixed or maximum price	Total potential stake
July 2015	Lee Family Investors	Shaftesbury Plc	Fixed	13.2%
May 2010	Water Hall Group Plc	Petards Group plc	Fixed	29.99%
August 2008	Wenhedge Limited	Beale plc	Fixed	28.23%
July 2006	Landers-Segal Color Co Inc	European Colour PLC	Fixed	29.99%

cash was available, the cash confirmer may be required by the Takeover Panel (the Panel) to produce the cash itself in the event that the funds are not forthcoming from the offeror (*see box "Partial offers"*).

Panel consent

All tender offers require the consent of the Panel before being made. The Panel will normally grant consent where the tender offer could not result in the offeror, and persons acting in concert with it, becoming interested in shares carrying 30% or more of the voting rights on the closing date of the tender offer or, less commonly, where the tender offer is by a person already holding shares carrying more than 50% of the voting rights of a company that is making an offer for less than all of the remaining shares held by the minority (*Appendix 5, paragraph 1, the Code*).

Minimum acceptance condition

Tender offers must be conditional on the receipt of tenders equalling at least 1% of the voting rights of the company. An offeror may seek to make a tender offer conditional on a higher minimum acceptance condition although this may not be higher than 5% unless approved in advance by the Panel. This restriction is intended to discourage offerors from using a tender offer as a method of testing market reaction to a given price in advance of a full takeover offer. Minimum acceptance thresholds higher than 5% are typically only seen in competitive situations, where the Panel is likely to conclude that there is minimal risk of a tender offer being used as a method of price discovery.

The Code does not provide a right for an offeror on a tender offer to waive the minimum acceptance condition. This can be contrasted with the position on full takeover offers, which are typically subject to a condition that the offeror must acquire 90% of the shares to which the offer relates and 90% of the voting rights of the offeree, with the offeror reserving the ability to treat the condition as fulfilled if a lower percentage of acceptances are received subject to the 50% plus one vote minimum threshold, which is required by Rule 10 of the Code.

The acceptance condition is contained in the newspaper advertisement or shareholder circular circulated to offeree shareholders (*see "Publishing a tender offer" below*).

Other conditions

A tender offer may not be subject to any pre-condition or condition other than the minimum acceptance condition referred to above. Therefore, a tender offer cannot be made conditional on competition clearances, shareholder approval, any form of financing condition or no material adverse change (MAC) event having occurred, as would be typical on a full or partial offer.

This inability to include conditions may make a tender offer unsuitable for certain potential purchasers and careful consideration should be given at an early stage as to whether a transaction can proceed without any conditions.

From a competition law perspective, even acquisitions of a minority shareholding in a company may give rise to merger control issues. For instance, in the UK, the Competition and Markets Authority (CMA) may review a transaction involving the acquisition of "material influence", which is the lowest level of control under UK merger control rules. This is also significantly lower than the European Commission's "control" threshold.

The CMA looks at the ability to exercise material influence over policy and strategic decisions pertaining to the company. The CMA will take into account several factors, such as the size of the relevant shareholding, the identity of the shareholder, the way in which other shares are dispersed, whether the shareholder has board representation enabling it to influence policy and the existence of any special rights attaching to the shareholding.

In April 2005, the CMA's predecessor, the Office of Fair Trading, decided that it had the jurisdiction to review First Milk Ltd's acquisition of approximately 15% of the issued share capital of Robert Wiseman Dairies Plc by way of a tender offer, which also gave First Milk the right to nominate a single non-executive director to the Wiseman board. The assessment of "material influence" will vary on a case-by-case basis, meaning that competition lawyers need to give careful consideration to the facts of every relevant tender offer.

Publishing a tender offer

The principal documents for effecting a tender offer, in the case of an offer for the shares of a company that is admitted to trading on a UK regulated market, such as the Main Market of the London Stock Exchange, or a multilateral trading facility, such as AIM, are advertisements placed in two national newspapers by the offeror. In practice, an offeror will also typically make a regulatory information service announcement containing details of the tender offer. In addition, the Panel will commonly consent to an offeror sending a circular to shareholders. Sending a circular ensures that retail shareholders who, unlike institutional shareholders, may not follow announcements published on regulatory information services, are also notified of the offer.

In all other cases, the tender offer must be made by sending a circular to shareholders and persons with information rights.

Partial offers

A partial offer is an offer to the shareholders of a company to buy only a proportion of their shares, as opposed to a full takeover when 100% of the shares of a company are sought. Many partial offers are made in order to obtain a holding in the offeree company of more than 30% but less than 100% of its total voting rights, but partial offers can also be used to acquire shareholdings of less than 30%.

As with tender offers, the Takeover Panel's (the Panel) consent is required for a partial offer, but the principal document is an offer document rather than a circular to shareholders. There are far more Takeover Code (the Code) obligations on a partial offer than on a tender offer, including the requirement to obtain the approval of the target shareholders holding over 50% of the voting rights not held by the bidder or its concert parties (*Rule 36.5*).

This is in line with the Panel's view that more complex transactions should be achieved by means of a comprehensive offer document that complies with the Code's requirements, whereas more straightforward offers to shareholders to sell their shares can be performed by means of a tender offer.

Because of this, tender offers have traditionally been more popular than partial offers although there have been very few examples of either in recent years. Only three partial offers have taken place in the UK since 2010.

There is no need to produce an offer document complying with the full content requirements of the Code.

Financial promotion

A tender offer constitutes a communication of an invitation or inducement to engage in investment activity under the Financial Services and Markets Act 2000 (FSMA).

Section 21 of FSMA provides that a person must not, in the course of business, communicate an invitation or inducement to engage in investment activity (that is, make or issue a financial promotion) unless:

- That person is authorised under FSMA.
- The communication is covered by an exemption.
- The content of the communication has been approved by an authorised person in accordance with the FCA rules.

In a full or partial takeover offer, some offerors will rely on Article 62 (sale of body corporate) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (*SI 2005/1529*) (as amended) as this provides an exemption for offer announcements and documents on the basis that the object of the transaction may reasonably be regarded as being the acquisition of day-to-day control of the offeree.

However, a tender offeror is unable to rely on this exemption. This is because a tender offer will not meet the applicable conditions, which include that the shares to which the financial promotion apply must carry 50% or more of the voting rights.

Accordingly, the tender offer advertisement or circular (or both) will need to be issued or approved as a financial promotion, normally by the offeror's financial advisers.

Posting a shareholder circular

There is no express obligation in the Code for an offeree to provide its shareholder register to an offeror on a tender offer to enable that offeror to post its circular.

Instead, an offeror that holds or acquires a share, or shares, in the offeree will typically be able to rely on section 116 of the Companies Act 2006 (2006 Act) (section 116), which gives shareholders a right to receive a copy of the shareholder register, unless the offeree can establish that the request is not for a proper purpose.

Where a company receives a section 116 request, it has five working days from receipt of that request to provide a copy of the register or, if it believes that the request is not made for a proper purpose, to refer the request to the court (*section 117, 2006 Act*). A shareholder register provided in response to a section 116 request only needs to be up-to-date as at the date of the request; unlike a takeover offer, there is no need for an offeree to provide updated registers during the course of a tender offer unless the requisitioning party submits a further section 116 request.

Careful thought therefore needs to be given as to how an offeror can verify the validity of, and announce the level of, tender offer acceptances within the short post-closing time period allowed by the Code using the potentially lengthy section 116 statutory procedure. One possible solution is to set a record date before the closing date of the offer, so that only shareholders that are on the shareholder register at the record date may accept the offer. This would potentially allow the offeror sufficient time to submit a section 116 request and verify which shareholders were on the shareholder register on the record date.

DEFENCES TO TENDER OFFERS

A tender offer is regarded by the Panel as a simple mechanism, akin to a market purchase, which is not appropriate for detailed arguments of the type found in full Code-compliant offer documents. Accordingly, an offeror is prevented from including any form of argument or persuasion in its circular or advertisement to offeree shareholders. The only persuasive information that may be included is a statement comparing the value of the tender offer with the market value of the shares being offered for.

By contrast, the board of directors of an offeree is not subject to the same explicit restriction and may publish a defence document or announcement in response to a tender offer, subject always to its wider statutory duties to act in the best interests of shareholders as a whole. Furthermore, as a tender offer is not a takeover offer, an offeree is free to make a profit forecast in support of its defence arguments without needing to have the profit forecast reported on by its advisers.

In theory, therefore, an offeror may be disadvantaged by the asymmetrical nature of the Code although, in practice, any defence will typically be limited to the issue of price. An offeree board may appear unduly defensive by constructing a wider defence where no arguments have been raised by the offeror.

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SUBSEQUENT OFFERS OR ACQUISITIONS

One theoretical advantage of a tender offer is the relative ease with which further tender offers, or even a full takeover bid, can be made following the making of an initial tender offer, whether successful or lapsed. Subject always to the overriding requirement to obtain Panel consent for the making of a tender offer (*see "Panel consent" above*), there are no timing restrictions as regards the making of a subsequent takeover offer, or even further tender offers, and an offeror is free to acquire interests in an offeree at any time following a tender offer, whether through market purchases or otherwise.

From a practical perspective, however, a tender offeror will often feel compelled to state that it will not be making a subsequent takeover bid for the offeree in order to persuade offeree shareholders to tender their shares. Otherwise, they are likely to wait for a bid.

If a voluntary statement of this nature is made, it will prohibit a potential offeror from announcing any takeover offer and severely restrict it from taking any steps in preparation for the making of an offer for a period of six months from the date of the statement. For this reason, a tender offer is not typically seen as an ideal starting point if a full bid is a possibility in the immediate future.

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