ADOPTING THE TAKEOVER CODE
WHO WILL BE THE REFEREE?

Guy Morgan of Fox Williams LLP explores the key legal and commercial issues associated with the voluntary adoption of the Takeover Code by companies that would otherwise not be subject to it.

George Foreman once joked that the referee is the most important person in the boxing ring, other than the boxers. A similar joke might be made about the UK Takeover Panel (the Panel), the regulator that acts as referee on the conduct of takeover offers in the UK.

But a strong counter-argument to those who may denigrate the value and effectiveness of the UK's takeover regime comes from looking at those London Stock Exchange-listed companies that fall outside the Panel's jurisdiction. The Takeover Code (the Code) does not apply to all companies quoted on the AIM Market or the Main Market of the London Stock Exchange. But in an attempt to provide shareholders in these companies with similar protections, it is common for the companies to elect voluntarily to incorporate the Code, or certain aspects of it, into their constitutions.

This article examines the implications and practicalities of this type of election, and of making takeover offers for companies falling in those categories.

THE REGULATORY FRAMEWORK

Of the over 950 companies whose securities are admitted to trading on AIM as at August 2017, approximately 160 have their registered offices outside the UK, Channel Islands or the Isle of Man. This means the Code does not apply to those companies. The Code also does not apply to certain Main Market listed companies that have their registered office outside the EEA and specified shared jurisdiction companies (*see box "Application of the Takeover Code"*).

Regardless of whether the Code applies, an overseas incorporated company will be subject to the laws of the country of its incorporation, including potentially the jurisdiction of the local takeover regulator.

ELECTING TO INCORPORATE THE CODE

It has become relatively common practice for companies listed on the London Stock Exchange that are not subject to the Code to include voluntarily certain provisions in their constitutional documents that seek to mimic parts of the Code. Indeed, sponsors or nominated advisers advising a non-Code company on a prospective London listing may specifically request that the company does so.

Among other things, this is intended to provide regulatory certainty to domestic investors that are familiar with UK takeover procedure, even if the reality may be somewhat different, and to minimise any perceived disadvantages of being an overseas company, thereby bolstering investor confidence.

This is despite the fact that, in certain circumstances, the Code not applying may be seen as an advantage. Code offers are subject to a comprehensive rule book, have a rigid timetable, are overseen by the Panel, can be expensive, and require extensive and specific information to be disclosed in the offer document.

To incorporate the Code voluntarily into a company's constitution, a typical provision might state: "In the event that circumstances arose wherein, if the Company were subject to the Code, the Company would be an offeree or otherwise subject of an approach or the subject of a third party's statement of firm intention to make an offer, the Board shall endeavour to comply and to procure that the Company complies with the provisions of the Code. In the event that the Board recommended to the Shareholders of any class thereof any takeover offer made for shares in the Company from time to time, the Board shall endeavour to obtain the undertaking of the offeror(s) to comply with the provisions of the Code in the conduct and the execution of the relevant offer."

Provisions of this nature might appear straightforward at first glance, but in fact they raise a number of difficult issues that must be addressed.

DECIDING WHICH CODE RULES TO APPLY

The provision of the Code that is most frequently adopted voluntarily is that contained in Rule 9, which requires a mandatory offer to be made by a person that acquires an interest in shares that exceeds specified thresholds. However, many companies will seek to adopt substantially the entire Code.

There are no legal requirements or standard market practice as regards how exactly a company might adopt Code provisions into its constitutional documents and there are numerous alternative approaches to this issue, with differing legal effect. Indeed, instead of directly copying Code provisions into their constitutions, many companies will adopt tailored or amended provisions of the Code, on account of the tailored provision being more appropriate for the particular company. The lack of a standard market approach to Code adoption can have the consequential effect of undermining the regulatory certainty and familiarity that might otherwise be provided to shareholders.

WHO WILL BE THE REFEREE?

Much like a boxing referee, the Panel is the supervisory authority that is responsible for supervising and regulating takeovers. Among other things, the Panel is available for consultation and also gives rulings on the interpretation, application or effect of the Code. The Panel is actively involved throughout the course of a takeover.

However, the Panel will not act on any matter falling outside its jurisdiction, even if the parties to a transaction request that it does so. Without the Panel to act as the supervisory authority, an appropriate referee must therefore be identified and be granted authority to determine how the Code should be interpreted and applied.

Board or existing adviser

One approach to this issue involves the board of directors of the target company, or a sub-committee of the board, being granted authority to determine the deemed application of the whole, or part, of the Code. This approach is cheaper than the alternatives because no third parties need to be engaged. However, it can be problematic as the board is not independent, its decisions are difficult to challenge, and it frequently lacks the requisite knowledge to perform the role without third-party support. In certain situations, including collective shareholder actions involving proposed board changes, the board may be directly conflicted in performing the role.

Similar independence issues arise when a company appoints its sponsor, nominated adviser, or relationship financial adviser to act instead.

Independent expert

Alternative approaches involve a company appointing an independent third party to act as the referee, commonly being a former member of the Panel executive.

When Henderson Group Plc acquired Main Market-listed Gartmore Group Limited in 2011 by means of a recommended takeover, the parties to that transaction jointly appointed a third-party Code expert. A similar approach was taken in the recommended takeover of AIM-quoted Charlemagne Capital Limited by Fiera Capital Corporation, where the parties jointly appointed a former Director General of the Panel as their Code expert.

In the recommended takeover of AIM-quoted Powerflute OYJ by Nordic Packaging and Container (Finland) Holdings OY, the parties agreed to appoint a Code committee comprising representatives of both the bidder and the target, but with the ability to refer any matter to a third-party Code expert in the event of a disagreement. The rulings of the Code expert were agreed by the parties, absent fraud or manifest error, to be final and binding on the parties.

While the appointment of a Code expert imposes an additional cost on the parties, this cost must be set against the document charge that would be ordinarily be payable to the Panel on the publication of a Code-compliant offer document. These fees range from between £2,000 on a deal valued at £1 million, to £350,000 on a deal valued at over £5 billion.

AGREEING TO PLAY BY THE RULES

In each of the examples of recommended offers referred to above, the parties to the offer entered into an implementation agreement, conditional on the announcement of the relevant offer, under which the bidder and the target contractually agreed to conduct themselves and the offer as if the offer were subject to certain requirements of the Code. The implementation agreements also set out the identity of the person(s) who would act as the referee, or the method of identifying a Code expert.

An implementation agreement is typically negotiated between the parties contemporaneously with the offer documents, and becomes effective on the public release of the offer announcement on a regulatory information service. The agreement may contain other provisions as regards co-operation between the parties, the timing of the offer and confidentiality, although these are not required to ensure compliance with the Code.

But while the entry into an implementation agreement in order to agree contractually the rules of the fight appears an elegant solution in the absence of a regulatory authority, it is not without its difficulties.

No unilateral enforcement

Regardless of what provisions a target company includes in its constitutional documents, it is difficult to unilaterally force other parties to comply with provisions of the

Application of the Takeover Code

The Takeover Code (the Code) will apply if the target company is:

- A company or a societas europaea (or, where appropriate, a company incorporated under charter or statute) (and not a company to which the shared jurisdiction provisions apply (*see below*)) whose registered office is in the UK, the Channel Islands or the Isle of Man if any of its securities are admitted to trading on a regulated market or a multilateral trading facility in the UK or on any stock exchange in the Channel Islands or the Isle of Man.

- A public company (listed or unlisted), a private company or a societas europaea (or, where appropriate, a company incorporated under charter or statute) (not falling within the bullet above and not a company to which the shared jurisdiction provisions apply (*see below*)) whose registered office is in the UK, the Channel Islands or the Isle of Man and which is considered by the Takeover Panel to have its place of central management and control in the UK, the Channel Islands or the Isle of Man, but in relation to a private company only when:

  - any of its securities have been admitted to trading on a regulated market or a multilateral trading facility in the UK or on any stock exchange in the Channel Islands or the Isle of Man at any time during the ten years before the relevant date; or

  - dealings or prices at which persons were willing to deal in any of its securities have been published on a regular basis for a continuous period of at least six months in the ten years before the relevant date, whether in a newspaper, electronic price quotation system or otherwise; or

  - any of its securities have been subject to a marketing arrangement as described in section 693(3)(b) of the Companies Act 2006 (that is, traded on a recognised investment exchange, as defined in the Financial Services and Markets Act 2000) at any time during the ten years before the relevant date; or

  - it has filed a prospectus for the offer, admission to trading or issue of securities with the registrar of companies or any other relevant authority in the UK, the Channel Islands or the Isle of Man (but in the case of any other such authority only if the filing is on a public record) at any time during the ten years before the relevant date.

(*See box "When does the Takeover Code apply?".*)

In each of the above cases, the relevant date is the date on which an announcement is made of a proposed or possible offer for the target, or the date on which some other event occurs in relation to the target company which has significance under the Code.

Where a company's securities are or have been admitted to trading on a multilateral trading facility in the UK, the Code will apply only if the company has approved trading, or requested admission to trading, of its securities on the relevant multilateral trading facility.

The Code also applies to certain offers for companies whose securities are traded on a regulated market where there is shared jurisdiction between the UK and other EEA member states.

Code and a company cannot force a bidder to enter into an implementation agreement.

Third-party bidders. This problem is particularly pertinent in the case of a company that receives a takeover approach which is less welcome or hostile. The bidder may refuse to enter into any form of contractual arrangement with a target company for fear of restricting itself unnecessarily. Indeed, a friendly bidder that enters into an implementation agreement with a target company, and the restrictions and prohibitions it entails, may find itself at a comparative disadvantage to a hostile bidder that does not.

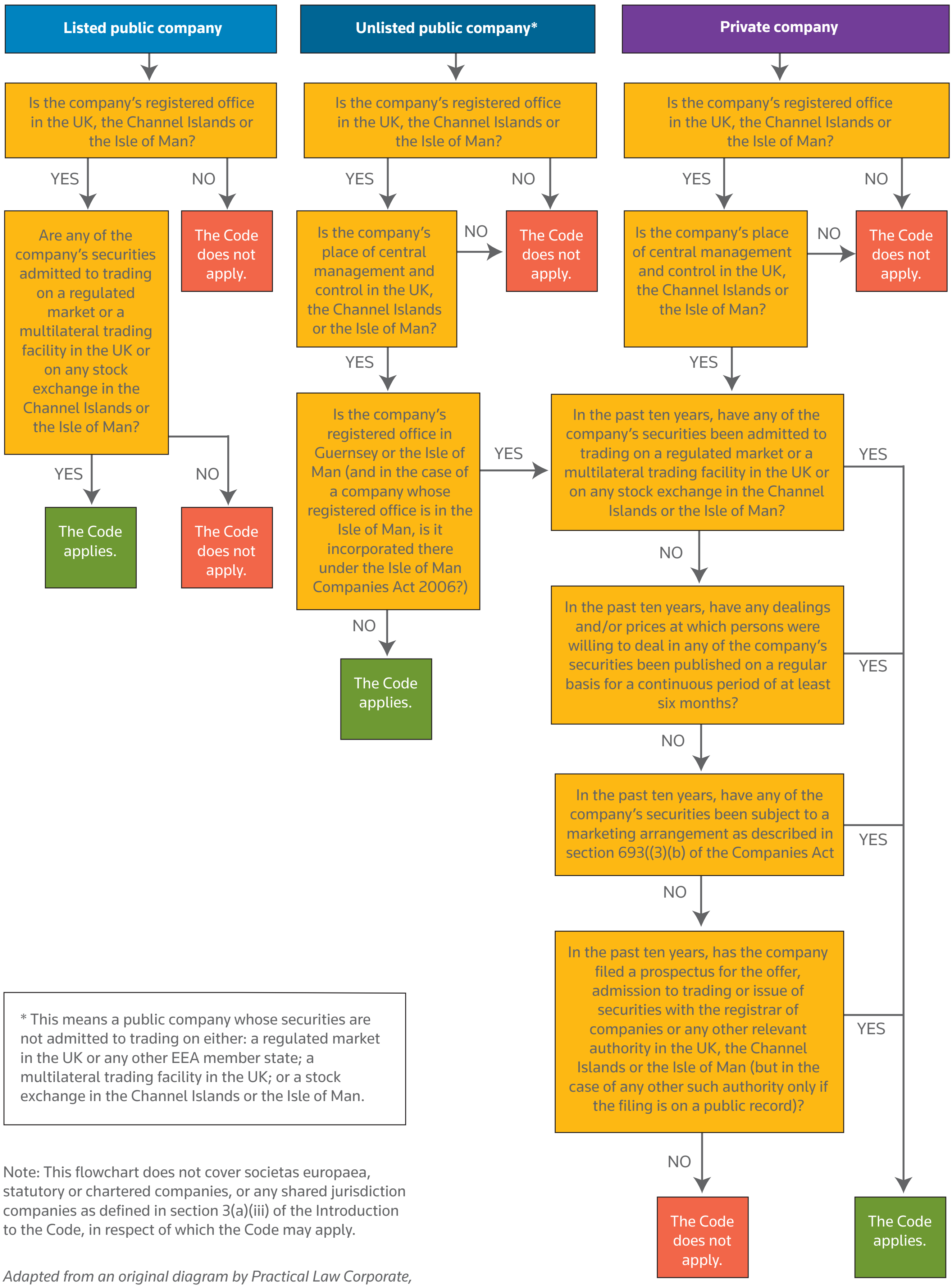
Take the so-called "put up or shut up" rule by way of example. Rule 2.6 of the Code requires a bidder for a Code company to make a formal offer for a target within 28 days after its approach or active consideration of a bid became public, by whatever means, or face a six-month standstill. This rule is designed to prevent companies from facing the disruptive impact of a prolonged hostile takeover, and effectively prohibits virtual bids, where a potential bidder makes an announcement that it is considering a possible offer for a target company but does not commit itself, resulting in a lengthy phoney war before its intentions are clarified.

In the absence of contractual agreement, a non-Code company has limited means of enforcing the "put up or shut up" rule on an unwilling counterparty. A non-Code company could therefore find itself subject to a disruptive virtual bid for an extended period.

It should be noted that, even where the parties to an offer do enter into a contractual agreement such as an implementation agreement, without the Panel acting as the relevant regulatory authority, a non-Code company's only method of recourse may be limited to that provided by the courts in respect of a breach of contract, including without limitation specific performance. While potentially effective as a method of recourse, this may be time-consuming and expensive.

To provide companies with an enhanced ability to enforce provisions in their constitutional documents, such as provisions that seek voluntarily to adopt the Code, it is therefore common to include provisions that allow a company to suspend voting rights or withhold the payment of dividends

When does the Takeover Code apply?



* This means a public company whose securities are not admitted to trading on either: a regulated market in the UK or any other EEA member state; a multilateral trading facility in the UK; or a stock exchange in the Channel Islands or the Isle of Man.

Note: This flowchart does not cover societas europaea, statutory or chartered companies, or any shared jurisdiction companies as defined in section 3(a)(iii) of the Introduction to the Code, in respect of which the Code may apply.

Adapted from an original diagram by Practical Law Corporate, which can be found at www.practicallaw.com/w-006-6928.

Examples of Takeover Code equivalent offers

Date	Bidder	Target	Market of target	Domicile of target
February 2017	Learning Technologies Group Plc	NetDimensions (Holdings) Limited	AIM	Cayman Islands
November 2016	Fiera Capital Corporation	Charlemagne Capital Limited	AIM	Cayman Islands
September 2016	Nordic Packaging and Container (Finland) Holdings OY	Powerflute OYJ	AIM	Finland
January 2011	Henderson Group Plc	Gartmore Group Limited	Main Market (Premium Segment)	Cayman Islands

from shareholders that do not comply. These types of provisions can be a useful enforcement tool, although there are limits as to their effectiveness. A third-party bidder will frequently hold no shares in a target company before the launch of a takeover offer and so would be unaffected by those enforcement provisions.

Target company shareholders. The problem of how to enforce adopted provisions of the Code on third parties is not limited to less welcome or hostile bidders. A target company may be also unable to unilaterally enforce Code provisions on other market participants, including its own shareholders.

Rule 8 of the Code is designed to provide transparency to the market by requiring persons with significant interests in either the target or a paper bidder to disclose publicly information in relation to their positions at the start of, and dealings during the course of, an offer period, including the prices at which they have dealt. Specifically, Rule 8 requires the disclosure of any dealings by a party to the offer or its concert parties, or by any person interested in, or who becomes interested in, 1% or more of any class of relevant securities of the target company or any securities exchange bidder.

In the absence of the Panel as the competent regulatory authority, a non-Code company may be unable to enforce the disclosure of this information by market participants. It is therefore common for companies to request publicly, rather than require, that market participants make voluntary disclosures as if the Code applied.

It should be noted that, regardless of whether the Code applies, companies listed in London and their shareholders are subject to the relevant general disclosure obligations contained with the Market Abuse Regulation (*596/2014/EU*), the Disclosure Guidance and Transparency Rules (DTR) and, if applicable, the AIM Rules. The provisions of DTR 5, which, in the case of UK-incorporated issuers, require the disclosure of any holding of voting rights of 3% or more (or holding or deemed holding through a direct or indirect holding of financial instruments) and any percentage change, apply irrespective of whether an offer period has begun. For non-UK incorporated issuers, the requirement under DTR 5 is to disclose any holding of voting rights of 5% or more (or holding or deemed holding through a direct or indirect holding of financial instruments) and then at 10%, 15%, 20%, 25%, 30%, 50% and 75%.

Cash confirmation

When a takeover offer is made for cash, both the firm offer announcement and the offer document must contain a confirmation by an appropriate third party that sufficient resources are available to the offeror to satisfy in full the acceptance of the offer (*Rule 2.7(d) and Rule 24.8, the Code*). The cash confirmation is typically given by the bidder's bank or financial adviser.

The giving of the cash confirmation usually requires a degree of financial due diligence from the adviser sufficient to justify an unconditional confirmation. The party confirming the availability of funding could be required by the Panel to produce the funding itself if it did not act responsibly in giving the confirmation. This cash confirmation requirement therefore gives a target company and its shareholders additional comfort as regards the availability of the offer consideration.

An offer for a company that is not subject to the Code need not, as a matter of regulation, contain a cash confirmation statement, although the target company's constitutional documents may directly or indirectly require it to do so. Even if a financial adviser does provide a cash confirmation statement in respect of a bidder's offer, it is an open question as to what, if any, the consequences would be for the financial adviser if the offer consideration was not forthcoming in the event that the financial adviser could be shown to have acted irresponsibly in giving the cash confirmation.

Assuming that the bidder's financial adviser was not party to any contractual arrangements with the target, which would be extremely unusual, the absence of a regulatory authority with statutory powers to enforce a cash confirmation statement means that a target company, or its shareholders, would potentially need to rely on the laws of misrepresentation to bring a claim against the financial adviser in that situation.

Intention statements

The Kraft Foods Inc/Cadbury plc takeover in 2010 saw Kraft state publicly that it intended to keep Cadbury's Somerdale factory open, only for Kraft to decide subsequently to close the factory, resulting in 500 job losses (*see News brief "Cadbury takeover: a krafty manoeuvre", www.practicallaw.com/1-501-5227*). This bid, together with the 2014 bid by Pfizer Inc for Astrazeneca plc, led to a number of related reforms to the Code that were intended to improve the quality of disclosure about a bidder's intentions for the target company and its employees.

These included: limiting the circumstances in which a bidder should be released from the requirement to adhere to a statement of intention; distinguishing between a post-offer undertaking, which is binding, and a post-offer intention statement; and requiring periodically after an offer period has ended the submission of a written report, or the delivery of a private confirmation as regards compliance with the relevant undertaking or intention statement (*see Briefing "Takeover Code changes: impact on private equity bidders", www.practicallaw.com/2-507-9308*).

Even if a bidder for a non-Code company elects, or agrees contractually, to include Code equivalent intention statements in its offer document, in the absence of a regulatory body mandated to monitor and enforce compliance, it is questionable as to how these statements might be monitored or enforced. Certainly it is unlikely that the target, having been acquired by the bidder, would be in any position to perform this role.

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Exclusions

Some of the rules of the Code may be felt to be inappropriate or unnecessary by the target or the bidder, or both. It is therefore common, when drafting constitutional provisions that seek to mimic parts of the Code, to either expressly exclude the application of certain rules or allow the board of the target company discretion to disapply specific rules of the Code as it sees fit.

Less controversial exclusions include disapplying the Code to the extent that it causes an inconsistency or conflict with the laws of the jurisdiction of the target company, including local takeover legislation.

Other exclusions may require more careful consideration by the target board, particularly where the exclusion may have the effect of deterring competing bidders from making an offer or leading to competing bidders making an offer on less favourable terms than they would otherwise have done. An example of a more problematic exclusion is allowing for the payment of break fees (being a cash sum payable by one party to an offer, typically the target, to another if certain specified events occur that cause an offer to fail), which would otherwise be prohibited (*Rule 21, the Code*). Other problematic exclusions include allowing the entry into bid conduct agreements, and permitting special deals to be entered into with specific shareholders without Panel consent, both of which are prohibited by the Code.

In the takeover of AIM-quoted Powerflute OYJ by Nordic Packaging and Container (Finland) Holdings OY, the parties agreed that the target, Powerflute, would not be required to comply with the Code to the extent that it would be automatically required to make available to any competing bidder the information that it had made available to Nordic Packaging. Powerflute also agreed that the restrictions contained in the Code as regards the number of shareholders from whom irrevocable undertakings to accept the offer could be sought before the offer announcement (typically six persons) would not apply.

In the takeover of AIM-quoted Charlemagne Capital Limited by Fiera Capital Corporation, the parties agreed to exclude the provisions of Rule 13 of the Code insofar as it would have restricted Fiera's ability to invoke certain regulatory conditions to the offer that related to the various regulatory authorities consenting to the proposed change of control, so as to cause the offer not to proceed. Rule 13 provides, among other things, that a bidder should not invoke a condition unless the circumstances are of material significance to the bidder in the context of the offer. The standard required to invoke this condition under the Code is therefore a high one, so by disapplying Rule 13, the bidder gained additional certainty as regards its ability to invoke the regulatory condition.

Any discretion granted to the target board as regards the application of the Code may, however, only be exercised in accordance with the directors' duties imposed by the laws of the target company's place of incorporation and care must be taken to ensure that the board acts in accordance with any relevant statements made in the company's prospectus, admission document or other public documents or announcements. Bidder requests for specific exclusions from the Code must be considered in light of these duties, although it is inevitable that the strength of the bargaining position of the respective parties will be a factor in determining whether or not to grant an exclusion. This would not be the case in a Code offer being supervised by the Panel.

While the appointment of a Code expert may help to protect a target company from undue pressure being exerted on it by a bidder as regards compliance with the Code after an offer has been made, in practice, the majority of negotiations regarding the application of the Code will occur before an offer is made, and typically therefore before the appointment of a Code expert.

Paradoxically, implementation agreements themselves are expressly prohibited under Rule 21 of the Code on account of being offer-related arrangements. That is, they are offer-related agreements entered into by an offeree company with an offeror or their respective concert parties. Therefore, an implementation agreement must expressly exclude the application of Rule 21 insofar as it applies to the agreement itself (*see box "Examples of Takeover Code equivalent offers"*).

On the face of it, mimicking the Code in a company's constitutional documents appears to be a simple way of providing shareholders with the protections that they would otherwise have had if the company were subject to the jurisdiction of the Panel. But in reality, ensuring that all the parties play by the rules without an official referee is difficult to achieve. If parties get it wrong, there is a risk of matters descending into an unseemly brawl, where the certainty that shareholders thought they were getting proves to be an illusion.

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