THE TAKEOVER PANEL

2003 ANNUAL REPORT

The Panel's 2003 Annual Report was published today. Attached are extracts from the Report by the Director General contained in the Annual Report, in which the following topics are addressed.

- Proposed takeover directive
- The importance of prior consultation with the Executive
- Offer announcements
- Acquisition of shares from a single shareholder
- No extension of Rule 9 offers to concert parties of the offeror
- Inducement fees on asset disposals
- Estimated value of unquoted paper consideration

The Annual Report can be found on the Panel's website: www.thetakeoverpanel.org.uk

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PROPOSED TAKEOVER DIRECTIVE

On 2 October 2002, the European Commission published a revised proposal for a Takeover Directive. In framing this new proposal, the Commission sought to retain core elements of the text of the Directive that narrowly failed to be adopted by the European Parliament in July 2001, whilst including new provisions seeking to address, in particular, the concerns raised by the European Parliament in relation to what has become known as the "level playing field" issue (i.e. equal treatment for shareholders across the EU).

The main new provisions contained in the proposal were: strengthened provisions preventing the board of a target company from taking defensive measures to frustrate a bid without the approval of shareholders; a mechanism whereby restrictions on voting rights and on the transfer of securities would no longer be enforceable following a successful takeover; disclosure provisions to ensure that a company's share structure and control mechanisms are fully transparent to the market; detailed provisions on the "equitable price" to be paid by bidders in the event of a mandatory bid; and squeeze-out and sell-out rights to deal with the problem of minority shareholders following a takeover bid.

The Commission stopped short of introducing the "full break-through" proposal which had been recommended by the group of experts in their January 2002 report. Whilst restrictions on voting rights and on the transfer of securities would no longer be enforceable following a successful takeover bid, entrenched double or multiple voting rights would remain undisturbed. The new proposal contained no guidance as to whether or not compensation would be payable to those shareholders who previously enjoyed the benefit of such restrictions.

Despite many intense negotiations following the publication of the revised proposal in October last year, Member States have yet to reach agreement on the revised proposal. Some Member States are unwilling to support Article 9 (frustrating action) unless Article 11 (break-through) is extended along the lines suggested by the expert group in order to enable a bidder to override double or multiple voting rights. Possible compromises to reach agreement might include the deletion of Articles 9 and 11 or significant dilution of the restrictions in Article 9. Although the Directive remains a minimum standards directive

(which, broadly, means the UK can have higher regulatory standards than specified in the Directive), the Panel would struggle to see the benefits of a Directive that removed or weakened Article 9 and hence allowed target company boards to frustrate offers against the wishes of their shareholders.

THE IMPORTANCE OF PRIOR CONSULTATION WITH THE EXECUTIVE

Paragraph 3(b) of the Introduction to the Code states that, where there is any doubt whatsoever as to whether a proposed course of action is in accordance with the General Principles or the Rules of the Code, the Executive should be consulted in advance.

There have been a number of recent instances where a party failed to consult the Executive in advance and proceeded on the basis of an incorrect interpretation of the Code. The appropriate remedy for the breach put the party in question in a materially worse position than if there had been prior consultation, due to the difficulty in putting matters right after the event.

The Executive is ready to respond rapidly to requests for rulings; parties and their advisers are strongly encouraged to take advantage of this facility.

OFFER ANNOUNCEMENTS

The Panel has always been concerned to ensure the maintenance of fair and orderly markets in connection with an offer. As a result, Rule 2.2 requires an announcement to be made where the offeree company is the subject of rumour and speculation or where there is an untoward movement in its share price. Under Rule 2.4, it will normally be sufficient for the announcement to state simply that offer talks are taking place or that the potential offeror is considering making an offer.

Note 1 on Rule 2.2 makes clear that parties should consult the Panel if they are in any doubt as to whether or not an announcement should be made. Also, the Note states that it is for the Panel to determine whether a share price movement is untoward for this purpose. However, parties should not delay an announcement in order to consult the Panel if it is clear that an announcement is required.

The requirement for consultation does not necessarily mean that the Panel will require an announcement to be made and the Panel will always consider the question in the light of all relevant factors.

Rule 2.2 also stipulates that an announcement is required where negotiations or discussions are to be extended to more than a very restricted number of people outside those who need to know in the companies concerned and their immediate advisers, and that an offeror wishing to approach a wider group should consult the Panel. In practice, the Panel must always be consulted prior to more than six external parties being approached. Like any other person privy to confidential price-sensitive information concerning an offer, the external parties approached must, as required by Rule 2.1, keep the offer discussions secret and such parties should not themselves approach additional third parties without consulting the Panel.

Under Rule 2.3, prior to an approach being made, the responsibility for making an announcement lies with the offeror who should therefore keep a close watch on the offeree company's share price and monitor the press, newswires and internet bulletin boards for any rumour and speculation. Once an approach has been made to the board of the offeree company, the primary responsibility for making an announcement will normally lie with the board of the offeree company. However, if the approach is rejected by the offeree, the announcement obligation will normally revert to the offeror as only the offeror will then know whether it intends to proceed with the offer. In cases of doubt as to where the announcement obligation lies, the Panel should be consulted.

ACQUISITION OF SHARES FROM A SINGLE SHAREHOLDER

Rule 5.1 and SAR 1 both impose certain restrictions on the acquisition of shares and/or rights over shares. Broadly, Rule 5.1 restricts acquisitions that take a person's voting rights in a company through 30%; and SAR 1 restricts the speed with which a person may accumulate between 15% and 30% of the voting rights in a company. In each case, an exception exists in the case of an acquisition from a single shareholder (see Rule 5.2(a) and SAR 2(a)).

A fund manager managing investment accounts on behalf of a number of underlying clients (whether or not on a discretionary basis) is not regarded as a single shareholder. Accordingly, the exceptions in Rule 5.2(a) and SAR 2(a) will not apply to a purchase from a fund manager unless the interest acquired represents the interest of a single underlying entity. In cases of doubt, the Panel should be consulted.

NO EXTENSION OF RULE 9 OFFERS TO CONCERT PARTIES OF THE OFFEROR

General Principle 10 sets out one of the fundamental tenets of the Code, namely that where control of a company is acquired by a person, or persons acting in concert, a general offer to all other shareholders will normally be required. Rule 9.1 elaborates on this, setting out the circumstances in which a shareholder will trigger an obligation to make a general offer. If the shareholder acquiring shares is acting in concert with others, all the relevant shareholdings are aggregated for the purposes of determining whether the bid obligation laid down in the Rule has been triggered. However, under Note 1 on Rule 9.2, the prime responsibility for making an offer lies with the person who makes the acquisition which causes the bid obligation to be triggered.

When a group of shareholders is acting in concert, the Panel treats them as being the equivalent of a single person. Usually, therefore, the person responsible for making the offer will extend it to all shareholders outside the concert party but not to members of the concert party itself. The Executive takes the view that the person with the responsibility for making the offer is free to extend it to other concert party members if it so wishes, but will not normally be required to do so.

INDUCEMENT FEES ON ASSET DISPOSALS

Rule 21.2 sets out certain safeguards which an offeree company must observe prior to agreeing to pay an inducement fee to an offeror or potential offeror. Note 1 on Rule 21.2 illustrates the type of arrangements to which the Rule applies.

Normally such arrangements are entered into between an offeree company and either an offeror or a potential offeror. However, on occasion, as part of its defence strategy, an offeree company may consider disposing of one or more of its assets or businesses to a third party and may wish to enter into an agreement to pay an inducement fee to that third party in connection with the transaction.

Although Rule 21.2 is not directly in point, the ability of an offeree company to enter into such an agreement is restricted by Rule 21.1(e). This Rule prohibits an offeree company from entering into a contract otherwise than in the ordinary course of business during the course of an offer or where it has reason to believe that a bona fide offer might be imminent, unless it has obtained the prior approval of its shareholders in general meeting. However, provided the proposed inducement fee is de minimis and provided the other safeguards set out in Rule 21.2 are observed, the Executive will normally permit such an agreement to be entered into without shareholder approval having to be obtained. For these purposes, an inducement fee will normally be considered to be de minimis if it is no more than the lower of 1% of the consideration for the asset disposal and 1% of the value of the offeree company calculated by reference to the offer price.

The Executive should be consulted at the earliest opportunity in all such cases where an inducement fee or any similar arrangement is proposed.

ESTIMATED VALUE OF UNQUOTED PAPER CONSIDERATION

Rule 24.10 requires that, when an offer involves the issue of unlisted securities, the offer document must contain an estimate by an appropriate adviser of the value of such securities. The Executive interprets this provision as applying in any case where the consideration securities are not publicly quoted.

The Executive is aware that occasionally a valuation of the offeror's securities might give rise to difficulties, for example where an offer is not recommended and the offeror is a vehicle with no substantive business of its own. The Executive may, therefore, consider that it is not appropriate to publish an estimated value pursuant to Rule 24.10 in circumstances where the offeror and its advisers have not had access to sufficient information relating to the offeree company to provide an estimated value of the consideration securities.

In such circumstances a statement to the effect that the adviser was not able to publish an estimate of the value of the consideration securities must be included in the offer documentation. In addition, where no Rule 24.10 valuation is published, it will not normally be possible for the offeror to satisfy the Executive that the value of its offer exceeds the price of any purchases of offeree shares that might have been made to which Rule 6 applies. Offerors should, therefore, ensure that no such purchases are made unless a Rule 24.10 valuation will be published or a full cash alternative is provided. If any such purchases are made and a valuation cannot be published, the Executive is likely to prohibit the offeror from proceeding with its offer until such time as any purchases cease to be relevant for the purpose of Rule 6.