

# THE TAKEOVER PANEL

## THE EUROPEAN DIRECTIVE ON TAKEOVER BIDS

The Takeover Panel welcomes the Government's proposals for implementing the European Directive on Takeover Bids in the UK.

The Takeover Panel has today published an Explanatory Paper setting out in broad terms how it intends to put into effect the necessary changes that will result from the Directive and the Government's proposals.

Welcoming the Government's proposals, Peter Scott QC, Chairman of The Takeover Panel, said

"We believe that the proposals set out by the Government today will, if finally adopted, secure the flexibility of approach and the speed and certainty of decision making that has been the hallmark of the Panel's takeover regulation. The proposals are firmly based upon the continued independence of the Panel and will enable us to maintain the constructive working relationship between the Panel and its regulated community in the interests of shareholders and markets.

We are also satisfied that enactment of these proposals will minimise the risk of tactical litigation during bids."

Commenting on the practical impact of the Directive and the Government's proposals, Richard Murley, Director General of the Panel, said

"The Directive and these proposals will require some limited changes for the Panel, its constitution, powers, and procedures and to the Code itself. The Panel has taken the opportunity to review its operations and today's Explanatory Paper explains some useful improvements that have emerged from this process. We are confident that the way the Panel works and its day-to-day relationship with its regulated community will be largely unaffected."

**Notes to editors**

1. The European Directive on Takeover Bids was agreed by the European Union on 21 April 2004, after almost 20 years of negotiation. It came into force on 20 May and must be implemented into the national law of each Member State by 20 May 2006.
2. The aim of the Directive is to set minimum standards across the European Union for the regulation of takeover bids. It is based on general principles, similar to those contained in the current UK Takeover Code, and includes requirements for a mandatory bid at an equitable price and the information to be included in offer documents.
3. The Directive requires the UK Government to appoint an authority to supervise the regulation of takeover bid matters as provided under the Directive. The UK Government has chosen to designate the Panel as the competent authority and thereby preserve its position overseeing the regulation of takeover bids in the UK.
4. In negotiating the Directive the UK Government secured the right for Member States to minimise the risk of tactical litigation, ensuring that the speed and certainty of decision making of the current UK system of takeover regulation could be preserved.
5. The Explanatory Paper sets out how the changes required by the Directive will affect both the Panel and the Code. Changes for the Panel relate to the scope of the Panel's jurisdiction, the Panel's constitution, the Panel's enforcement powers and sanctions and the Panel's duty to co-operate with overseas regulators. Changes to the Code will affect both the General Principles and the Rules themselves but, overall, there will be few changes of substance.

6. The Panel will develop more detailed proposals over the coming months and a further paper, including a revised Introduction to the Code and detailed Rule changes, will be published later in the year seeking views as appropriate.
7. Further copies of the Explanatory Paper may be obtained from the Panel's website, [www.thetakeoverpanel.org.uk](http://www.thetakeoverpanel.org.uk).

### **Contacts**

Richard Murley, Director General

Noel Hinton, Deputy Director General      Tel: +44(0) 207 382 9026

20 January 2005

# THE TAKEOVER PANEL

## EXPLANATORY PAPER

### IMPLEMENTATION OF THE EUROPEAN DIRECTIVE ON TAKEOVER BIDS

#### **Introduction**

The European Directive on Takeover Bids (“the Directive”) completed its European legislative process on 21 April 2004 after almost 20 years of negotiation. It came into force on 20 May and must be implemented by 20 May 2006.

On 20 January the Department of Trade and Industry (“DTI”) published a Consultation Document containing its proposals for the implementation of the Directive. The Takeover Panel (“the Panel”) is publishing this paper, which should be read in conjunction with the DTI’s Consultation Document, to explain in broad terms how it intends to put into effect the necessary changes that will result from the Directive and the Government’s proposals if adopted.

The changes will affect the Panel, its constitution, powers and procedures, and the Takeover Code (“the Code”) itself. The Panel has also taken this opportunity to review its operations and the paper explains some useful improvements that have emerged from this process. In practice, the Panel is confident that the way the Panel works and its day-to-day relationship with its regulated community will be largely unaffected.

More detailed proposals will be elaborated over the coming months and a further paper, including a revised Introduction to the Code and detailed Rule changes, will be published later in the year, seeking views as appropriate.

**The Panel takes this opportunity to invite general observations on the changes described below and also to invite readers to respond to the DTI’s Consultation Document which may be viewed at [www.dti.gov.uk/cld/current.htm](http://www.dti.gov.uk/cld/current.htm).**

## **History and background**

The Directive is an important part of the European Union's Financial Services Action Plan which aims to create an integrated market in financial services throughout the EU. It is a minimum standards measure, providing a basic framework for the regulation of takeover bids, based on general principles and includes certain fundamental requirements relating to the obligation for a mandatory bid at an equitable price, the information to be included in offer documents and the right of a majority shareholder to buy out the minority following a successful takeover. It also enables Member States to put in place measures to minimise the risk of tactical litigation during the course of a bid.

However, the Directive's long and at times tortuous history led to certain compromises which are less than ideal, most notably in relation to frustrating action by offeree companies. For example, it proved impossible to reach a consensus among Member States on the need for offeree company boards to be prevented from taking defensive measures other than with the consent of the shareholders at the time of the bid. The decision as to whether to impose these restrictions is therefore optional under the Directive for each Member State. The Panel believes this is a major weakness of the Directive as a harmonising measure, though, given the Government's stated intention to impose such a requirement, it will not affect current measures in the UK to prevent frustrating action which has not been approved by shareholders.

While the Panel believes that the Directive will do little to improve the UK system of takeover regulation, the final text should, if implemented appropriately, enable the current working approach to continue largely unchanged. Indeed, the Directive embodies many of the core values and concepts contained in the Code.

However, the Panel has always been aware that, ultimately, the method of implementation of the Directive in the UK would be critical for the preservation of the key strengths of the current system of takeover regulation. The Government is required to designate a supervisory authority to supervise bids for the purpose of rules made pursuant to the Directive. The Panel, as the body which has been carrying out this function since 1968, welcomes the DTI's conclusion that it should remain the

regulator of takeover activity in Great Britain. However, the Panel has naturally been concerned that the legislation required to implement the Directive should preserve the current successful working arrangements.

Over recent months, the Panel has, therefore, been engaged in detailed discussions with the DTI in the preparation of its proposals for implementation of the Directive, with a view to ensuring that the Panel and the key features of its current system of regulating takeover bids, promulgating rule changes and administering and applying the Code may be retained. In particular, the Panel has stressed the importance of preserving the flexibility of approach and the speed and certainty of decision-making that the current system offers. The Panel's main objectives in these discussions have been as follows:

- to retain the ability of the Panel to be responsible for its own organisation and procedures;
- to maintain the Panel's independence;
- to maintain the existing relationship between the Panel and its regulated community;
- to minimise the risk of tactical litigation during bids;
- to preserve the Panel's power to specify the companies and transactions subject to its jurisdiction where these fall outside the minimum standards of the Directive; and
- to have all detailed provisions relating to rules and procedures set out in a unified form in the Code.

The proposals in the DTI consultation document reflect this approach and the Panel is therefore able to give them its support. They provide, in particular, for the Panel to act as the supervisory authority for the purposes of the Directive and for the

establishment of a statutory regime in primary legislation, giving the Panel the necessary rule-making and other powers to carry out that role. The legislation will also include measures to limit the possibility of tactical litigation and to give immunity to the Panel and those involved with it in the exercise of its regulatory functions. The Panel agrees that, of the options for implementation considered by the DTI, primary legislation is the only one capable of maintaining the advantages and strengths of the current system.

The proposed legislation will mark a new chapter in the history of the Panel. However, the Panel is confident that the DTI's proposals will preserve the Panel's independence and autonomy and the speed, flexibility and certainty of takeover regulation in the UK, while providing the Panel with the powers it will need and satisfying the requirements of the Directive.

The changes that will be required by the Directive and the DTI's proposals affect both the Panel and the Code.

Changes for the Panel affect:

- the scope of the Panel's jurisdiction;
- its constitution and the functions of its constituent committees;
- proposed new powers to obtain information and enforce the Code;
- the sanctions it will be able to impose; and
- confidentiality of information and co-operation with other regulatory authorities both within the UK and overseas.

In addition, the Panel is proposing some changes to its judicial procedures.

Changes to the Code will affect both the General Principles and the Rules themselves but are not of a fundamental nature. The SARs will be largely unaffected.

All of these changes are described in broad terms below.

### **Changes for the Panel**

In preparing for the procedural and constitutional changes outlined above, the Panel has undertaken a complete review of the Introduction to the Code. The following section of this paper explains the key changes in more detail.

#### ***Scope of the Panel's jurisdiction***

The scope of the Directive is different from, and generally narrower than, the current scope of the Code. The DTI is, however, proposing that the Panel's regulatory authority under the legislation should cover both companies and transactions covered by the Directive and those other companies and transactions not within the scope of the Directive but currently regulated by the Panel. It also proposes that the Panel should have the flexibility to make rules to deal with future market developments in the field of takeovers as they arise. The Panel agrees that this is the right approach.

The major points to note are as follows:

- **UK registered and traded companies**

Any offer for a company that has its registered office in the UK and has any of its securities admitted to trading on a UK regulated market<sup>1</sup> will be covered by the Code. ***The current residency test<sup>2</sup> will therefore no longer apply to these companies.***

---

<sup>1</sup> Currently, the London Stock Exchange, virt-x, LIFFE and EDX.

<sup>2</sup> "The Panel will normally consider a company to be resident only if it is incorporated in the UK, the Channel Islands or the Isle of Man and has its place of central management in one of those jurisdictions."



- **Other public and private companies**

The Code will continue to apply to all offers for other listed and unlisted public and certain private companies (other than those offers subject to shared jurisdiction –see below) in the same way as it does now<sup>3</sup>. *The residency test will continue to apply to these companies.*<sup>4</sup>

- **Shared jurisdiction**

In accordance with Article 4.2 of the Directive, the Panel will share the regulation of an offer with an authority in another EU Member State when the offeree company is:

- (a) a UK registered company whose securities are not admitted to trading on a UK regulated market but are admitted to trading on a regulated market in one or more other EU Member States;
- (b) a company registered in another EU Member State whose securities are admitted to trading only on a UK regulated market; or
- (c) a company registered in another EU Member State whose securities are admitted to trading on regulated markets in more than one EU Member State including the UK if:
  - The company’s securities were first admitted to trading on a UK regulated market;
  - The company’s securities were first admitted to trading simultaneously on several markets before 20 May 2006, if the relevant regulatory authorities agree that the Panel is to regulate the company or, failing that, the company chooses to be regulated by the Panel; or

---

<sup>3</sup> These include companies traded on AIM and OFEX, which are not “regulated markets”

<sup>4</sup> The Panel understands that the authorities in the Channel Islands and the Isle of Man are considering whether the Code should continue to apply to companies incorporated in those jurisdictions.

- The company's securities are first admitted to trading simultaneously on several regulated markets on or after 20 May 2006 and the company chooses to be regulated by the Panel.

Under (b) and (c) above, the Panel will have responsibility for regulating matters relating to the bid procedure (e.g. disclosure of information and bid price) and under (a) it will have responsibility for matters relating to company law (e.g. fixing the control threshold for a mandatory offer and provisions relating to frustrating action). In each case, a regulatory authority in another EU Member State will have to take responsibility for matters not regulated by the Panel.

It is not yet clear how these shared jurisdiction provisions will operate in practice. This will be a matter for discussion with authorities in other EU Member States.

- **Transactions covered by the Code**

Except in the shared jurisdiction cases set out above, the Code will apply, as it does now, to takeover and merger transactions, however effected, of the relevant companies. As now, these will include, among others, partial offers, offers for minorities, schemes of arrangement and dual holding company transactions.

In the shared jurisdiction cases, the Code will apply only to those offers which are covered by the Directive i.e. public control-seeking offers (whether mandatory or voluntary) of the companies concerned.

These provisions will be set out in the revised Introduction to the Code ("the Introduction").

The application of the Code to non-Directive takeover transactions (e.g. schemes of arrangement) for companies in category (a) of the shared jurisdiction cases (UK registered companies), is yet to be determined. The Panel believes that the Code should apply, though this will have to be subject to discussions with the regulatory

authorities in the EU Member States on whose regulated markets the offeree company's securities are admitted to trading.

### ***The Panel's constitution***

The DTI is proposing that the implementing legislation should establish the basic elements of the Panel's constitution but that the Panel, which will continue as an unincorporated association, will retain autonomy to determine the detail. The Panel welcomes this approach which will enable it, within the legislative framework, to continue to be flexible in adapting its operations to meet changing needs.

The key features of the DTI's proposal are that the legislation will provide that the rule-making and judicial functions of the Panel will have to be carried out by separate committees of Panel members and that membership of those committees will have to be mutually exclusive. The Executive will continue with its current functions. This reflects the current structure which has been in place since 2001, when the rule-making functions of the Panel were delegated to the Code Committee in order to comply with human rights legislation. However, the Panel has taken this opportunity to review its functions and procedures together with those of its constituent committees and of the Executive and it will be making a number of changes as a result.

In the interests of clarity and transparency the Panel will spell out all of these functions and procedures in detail, in the new Introduction.

The main elements of the proposed new constitution, including appointments procedures, are described below.

- The rule-making functions of the Panel will continue to be carried out by the Code Committee, but its members will become members of the Panel.
- The judicial functions of the Panel will be carried out by the Hearings Committee, all of whose members will also be members of the Panel.

- No Panel member will be able simultaneously to be a member of both the Code Committee and the Hearings Committee. Moreover, no-one who has been a member of the Code Committee will subsequently be able to be a member of the Hearings Committee.
- All Panel members will be able to participate in plenary sessions to discuss administrative, financial and policy matters.
- A Nomination Committee will be established to lead the process for the appointment of the Chairman, Deputy Chairmen and independent Panel members (all of whom will be members of the Hearings Committee) and of the members of the Code Committee. These appointments will be made by the full Panel, on a recommendation of the Nomination Committee.
- Panel member organisations will continue to nominate Panel members as they currently do (all of whom will be members of the Hearings Committee).
- A Remuneration Committee will be established.
- The Appeal Committee will be renamed the Appeal Tribunal.
- The Chairman and Deputy Chairman of the Appeal Tribunal will be appointed by the Master of the Rolls.
- Other Appeal Tribunal members will be drawn from a pool (not including current Panel members) and appointed by the Appeal Tribunal Chairman (or Deputy Chairman).
- The Executive will continue to perform its current role and functions.
- There will be no change in the relationship between the Executive and the Panel.

As part of the review of its constitution, the Panel has been considering whether to widen its membership. It believes that it would be appropriate to increase the number of independent members (currently three – drawn from the senior management of major companies) by the addition of an individual with experience of employee relations issues from the employee's perspective. In recent years a number of policy issues have arisen which may affect takeover regulation and which have an employee relations element (for example the Information and Consultation Directive and issues facing pension fund trustees) and the Panel believes that its consideration of these issues would be enhanced by the contribution of an individual with this background. However, the Panel stresses that its function will continue to be, as stated in the Introduction to the Code, to ensure fair and equal treatment of all shareholders in relation to takeovers.

The Bank of England played an important role in setting up the Panel in 1968 and since then has supported its activities in a number of ways. In particular, the Governor of the Bank has had responsibility for making the key appointments of the Chairman and Deputy Chairmen and independent Panel members. The Panel recognises, however, that the role and priorities of the Bank have changed in recent years. It has, nevertheless, been keen to maintain a link with the Bank under the new arrangements and is therefore pleased that the Bank has agreed to nominate one member to both the Nomination and the Remuneration Committees.

The Panel will publish an Annual Report covering matters including a report on takeover activity, market developments, Code changes, the Panel's constitution and its financial position.

### *Judicial procedures*

- **The Hearings Committee**

As explained above, the judicial functions of the Panel will be carried out by the Hearings Committee, which will be chaired by the Chairman of the Panel or one of his Deputy Chairmen. Thus, any appeal against a ruling of the Executive,

certain disciplinary hearings and any matter which is particularly unusual, important or difficult which the Executive may refer to the Panel will be heard by the Hearings Committee. The procedures of the Hearings Committee will be set out in the Introduction but will be the same in substance as the procedures currently followed by the Panel in hearing such matters.

- **The Appeal Tribunal**

The Appeal Tribunal will hear appeals from decisions of the Hearings Committee. At present, there is a right of appeal to the Appeal Committee where:

- (a) the Panel finds a breach of the Code and proposes to take disciplinary action;
- (b) it is alleged that the Panel has acted outside its jurisdiction; or
- (c) the Panel refuses to recognise, or decides to cease to recognise, an exempt market-maker or principal trader or exempt fund manager.

In other cases, an appeal can only be made to the Appeal Committee with leave of the Panel.

In addition to the existing rights of appeal, the Panel is proposing somewhat to increase access to the Appeal Tribunal, so that all determinations of the Hearings Committee may be appealed to the Appeal Tribunal on grant of leave. The procedure will be that any application for leave to appeal should first be made to the Hearings Committee but if such leave is refused, an application for leave may be made directly to the Chairman of the Appeal Tribunal.

The procedures of the Appeal Tribunal will be set out in the Introduction but will be the same in substance as the procedures currently followed by the Appeal Committee.

### ***Enforcement powers***

The DTI explains in its Consultation Document that in order to comply with the Directive, it is necessary to provide the Panel with certain new enforcement powers. The Panel has always sought to ensure compliance with the Code through a consensual approach with parties engaged in takeover activity and it has done so successfully. It intends to continue to follow this approach but nevertheless accepts that the new powers are required by the Directive. These powers will be provided for in the legislation but, with a view to keeping all matters concerning the regulation of takeovers contained in the Code itself, each of the new powers described below will be set out in the Introduction as well.

- **Providing information and assistance to the Panel and the Panel's information gathering power**

The Panel has always expected co-operation from those with whom it deals and will continue to do so but the obligations of persons dealing with the Panel will be set out in more detail in the new Introduction. In particular, it is proposed to state specifically that any person dealing with the Panel or to whom inquiries or requests are directed must take all reasonable care not to provide false or misleading information to the Panel. In addition, any person subject to the Code will be under an obligation to disclose to the Panel any information relating to him or her, of which the Panel might reasonably expect to be notified. Failure to co-operate or to disclose information to the Panel will be a serious breach of the Code.

In addition, the DTI proposes that the Panel should have a formal statutory power to require persons in possession of information or documents reasonably required by the Panel in connection with the exercise of its functions to pass that information or those documents to the Panel. The Panel accepts that such a power will be an essential element of the implementation package although it would expect to exercise the power formally only on rare occasions.

The Panel's new information gathering powers would be subject to legal privilege.

- **Compliance and compensation rulings**

The DTI is proposing that the Panel should be given the power to make a ruling restraining any breach (or further breach) of the Code or a Panel ruling or requiring the person concerned to take such steps as the Panel may specify in order to remedy the breach or secure compliance, if the Panel is satisfied that:

- There is a reasonable likelihood that a person will breach the Code or a ruling of the Panel or that a person has breached the Code or a ruling of the Panel and there is a reasonable likelihood that the breach will continue or be repeated; or
- That a person has breached the Code or a ruling of the Panel and there are steps that might be taken to remedy the breach; or
- It is necessary to secure compliance with the Code or a ruling of the Panel.

In addition, the Panel will be given a power to require the payment of compensation in cases where there has been a breach of any of Rules 6, 9, 11, 14, 15, 16 or 35.3. This would happen if the Panel ruled that the person committing the breach should make such payment to holders, or former holders, of the relevant securities in order to ensure that they would be placed in the same position as if the relevant Rule had been complied with.

- **Court orders**

The DTI is also proposing that the legislation should provide the Panel with further powers to enforce the compliance and compensation rulings and its power to request documents and information if necessary. The mechanism for



enforcement will be by way of application by the Panel to the court to secure compliance with a Panel ruling or request.

It is now, and will continue to be, the Panel's practice to focus on the specific consequences for shareholders of breaches of the Code, with the aim of preventing such breaches before they occur or providing appropriate remedial or compensatory action in a timely manner. The Panel believes that the consensual approach is most effective in securing the appropriate remedy or compensation but accepts that the extra powers will be a helpful reinforcement of this approach.

Any failure to comply with a resulting court order would be a contempt of court.

The Panel would intend to exercise its power to seek a court order only as a matter of last resort or in urgent cases.

### *Sanctions*

The DTI notes in its Consultation Document that the Panel has achieved a high level of compliance with the Code by using the sanctions currently available to it and that its prime regulatory focus is in remedying breaches by ensuring compliance during the course of a bid. It therefore concludes that it will not be necessary to extend to the Panel any further formal powers of sanction, such as a fining power.

The Panel welcomes this conclusion; it does not believe that a fining power would in practice add significantly to the deterrent or protective effects of its existing sanctions. Furthermore, a number of breaches of the Code may also constitute insider dealing or market abuse under the Financial Services and Markets Act 2000 ("FSMA") where criminal sanctions, civil fines and other sanctions may apply.

Therefore, the Panel's sanctions, which will be set out in the new Introduction, will remain largely unchanged as:

- private censure;

- public censure;
- reporting conduct to another regulatory authority or professional body (so that they might consider whether to take disciplinary or enforcement action); or
- taking action for the purposes of the ‘cold-shouldering’ procedures, under which the rules of the FSA and certain professional bodies oblige their members in certain circumstances not to act for a person named by the Panel, in a transaction subject to the Code.

The DTI also suggests that section 143 of the FSMA under which, at present, the FSA endorses the Code, will not be required once the Code has legal force. The Panel agrees that endorsement will no longer be required under the proposed new regime. However, it does not believe that repeal of section 143 will in any way weaken the overall enforcement and sanctions regime. The Panel works closely with the FSA, particularly in relation to matters relating to possible market misconduct in accordance with the joint operating guidelines, which can be viewed on the FSA’s website ([www.fsa.gov.uk](http://www.fsa.gov.uk)). The Panel and the FSA will be reviewing those guidelines in the light of the proposed legislative changes to ensure that they continue to provide clear and effective procedures for handling market misconduct during the course of a bid.

The Panel believes that its sanctions, together with the new powers described above will provide it with an appropriate portfolio of enforcement measures.

### ***Confidentiality and co-operation with other authorities***

The Panel has always maintained a policy of confidentiality in relation to the information it receives in the course of its regulatory activities. However, as a result of Article 4.3 of the Directive, any information received by the Panel will be made subject to a statutory confidentiality obligation. This will prevent any such information being passed on, other than as permitted under the implementing legislation.

In addition, the Panel has always maintained good co-operative relationships with other regulators in the UK, in particular the FSA, as described above, and with regulators overseas, both within and outside the EU. Article 4.4 of the Directive requires takeover regulatory authorities to co-operate with their counterparts in other EU Member States and with other EU financial regulatory authorities. The DTI therefore proposes to place the Panel under a duty to co-operate and provide such assistance to other EU regulators as it may consider appropriate.

In order to enable the Panel to comply with both the confidentiality and co-operation obligations, the DTI is proposing that the legislation should provide the Panel with 'gateways' through which information may legally be passed to authorities both within the UK and abroad. When information is passed to other regulators in the UK, it will continue to be subject to the same restrictions as will apply when it is in the Panel's possession.

Both the duty of confidentiality and the duty to co-operate will be described in the new Introduction to the Code. The detailed gateway provisions will not be included in the Introduction but will be contained in secondary legislation and made available on the Panel's website ([www.thetakeoverpanel.org.uk](http://www.thetakeoverpanel.org.uk)).

### **Changes to the Code**

As explained above, the DTI is proposing that the Panel should be given a power to make rules in relation to all of the Panel's activities. This power will therefore apply not only to rules deriving from the Directive but also to rules relating to other matters currently covered by the Code and to the SARs. Post-implementation, changes to the Rules and the SARs will continue to be promulgated by the Code Committee in accordance with its established consultation procedures, which will be set out in the Introduction.

However, certain changes will have to be made to the Code as part of the implementation process. The consultation procedures permit the Code Committee to make amendments to the Code and SARs without recourse to external consultation

where, ‘in the opinion of the Code Committee, changes are necessary or desirable as a consequence of changes to relevant legislation or rules’. Clearly, changes required by the Directive will fall into this category. However, this paper sets out a general description of the changes that the Code Committee believes will be needed. It also describes the Code Committee’s proposed method of making those changes.

As mentioned above, later in the year, when more detailed work has been undertaken, a further paper will be published, setting out the Code changes in full and consulting where appropriate.

### ***The General Principles***

The Directive contains a set of general principles in Article 3. This is set out in Appendix 1. These Directive principles were based on those in the Code but differ from them in a number of respects. The Code General Principles are contained in Appendix 2.

The key differences between the two sets of principles can be summarised as follows:

- Article 3 provides six general principles, while the Code has ten;
- of the Directive’s six principles, five find equivalents in the Code, but one (Article 3.1(f)) has no equivalent Code General Principle, though it is reflected in a number of existing Code Rules.; and
- of the Code’s ten principles, two (General Principles 5 and 8) find no equivalent and two (General Principles 9 and 10) find only partial equivalent in Article 3.

Having said this, much of the overall substance and content of the Directive general principles is very similar to the Code General Principles.

### *How to incorporate the Directive principles in the Code*

The Code Committee considered the possibility of combining the two sets of principles, retaining those Code General Principles that are not reflected in Article 3 and modifying others to bring them into line. However, the Directive provides that any derogations or waivers from rules made to implement the Directive have to respect the Directive principles. Therefore, even if the Panel were to retain those of its General Principles that are additional to those in the Directive, all derogations/waivers from the Rules would have to be made by reference to the Directive principles alone. As a result, Code changes would have to be made in any event.

With this in mind, the Code Committee, having analysed the comparison of the two sets of principles above, takes the following view.

- i) Because the two sets of general principles are very similar in substance and content, using Directive general principles and moving elements of the Code General Principles to the Rules will not result in a major change.
- ii) To the extent that an existing General Principle is inconsistent with a Directive principle, or less powerful, the Directive wording will need to be followed.
- iii) For the most part, anything that is included in a Code General Principle but not in the Directive can be reflected in a Rule (and in many cases is so reflected already). The Code Committee believes that moving a provision from a General Principle to a Rule would not in any way downgrade it; a General Principle might be more broadly worded, but in practice, there would be little difference if it became a Rule.

In sum, therefore, the Code Committee believes that the most practical approach to implementation of the Directive principles will be to adopt them in place of the existing General Principles in the Code. At the same time, a number of amendments will be made to the Code to incorporate the effect of those Code General Principles (or parts thereof) which will disappear. These changes are outlined in Appendix 3.

### ***Code Rules***

The Code Committee has carried out an initial review of the Code to identify the areas where changes will be necessary to comply with the Directive. As mentioned above, further work will be carried out over the coming months on the detailed Rule changes.

The Directive sets a minimum standard only, and permits the Panel to have Rules which go beyond those minimum requirements. Furthermore, on many matters, the Directive is permissive or silent and therefore has no Code implications. Therefore, apart from the changes to the Introduction and the General Principles described above, the amendments required do not appear to be extensive. They fall into three categories:

#### ***a) Completely new requirements***

There are only a few of these, mainly concerned with the offeror and offeree companies providing information about a bid to their respective employees and, in certain circumstances, in the case of the offeree company, giving them the opportunity to comment (Articles 6.1, 6.2, 8.2 and 9.5). There will also be some additions to the information to be included in the offer document in Rule 24.1 and in the offeree board's views on the offer required under Rule 25.

#### ***b) Derogations and waivers***

It has already been mentioned above that the Panel will be obliged, in granting any derogations/waivers, to respect the general principles. However, the power to grant derogations/waivers is qualified further in the Directive. Article 4.5 of the Directive sets out the circumstances in which derogations from, or waivers of, Rules may be granted. Essentially this says that a derogation may be granted or a waiver given if it is either specifically provided for in a Rule or in other specific circumstances, in which case a reasoned decision must be given.

The DTI is therefore proposing that the Panel should be provided with a statutory power to grant derogations and waivers consistent with Article 4.5 and that, in the light of the proposal for a single regime covering both Directive-based Rules and the

Code's other Rules, this power should apply in relation to all Code Rules. It will therefore be necessary for the Panel to consider all derogations and waivers to the Rules by reference to the new Directive general principles.

A number of specific derogations are already set out in the Code (and some are dealt with in more detail below) but there are also cases in which it is the Panel's practice at present to use its general power of discretion to grant derogations on a fairly regular basis in appropriate circumstances. The Code Committee will consider whether any more derogations of a specific nature should be written into the Rules.

**c) Other Code amendments**

On some matters the Directive is specific and the Code will have to be modified to comply. The most significant examples are as follows:

**(i) Definition of 'Acting in concert'**

The Directive defines "persons acting in concert" as follows:

*"natural or legal persons who co-operate with the offeror or the offeree company on the basis of an agreement, either express or tacit, either oral or written, aimed either at acquiring control of the offeree company or at frustrating the successful outcome of a bid."*

The Code definition reads:

*"Persons acting in concert comprise persons who, pursuant to an agreement or understanding (whether formal or informal), actively co-operate through the acquisition by any of them of shares in a company to obtain or consolidate control (as defined..) of that company."*

The Directive definition differs from the Code definition in three key respects:

- it does not require 'active' co-operation between parties;
- it is not limited to parties co-operating through the acquisition of shares by any of them; and

- it includes persons who co-operate with the offeree company with a view to frustrating the successful outcome of a bid.

The Code definition will, therefore have to change to come into line with the Directive definition.

The Code Committee believes that the first two of these changes will bring the definition more into line with the Panel's current practice. At present, the Panel may rule that parties are acting in concert even though, at the time, they are not actively engaged in the acquisition of shares. The consequences of such a ruling then bite under Rules 6, 9 and 11 when any of the relevant parties do acquire shares. This is how the Directive definition is drafted, with the mandatory bid obligation in Article 5 being triggered as a result of an acquisition of securities in a company by any member of a concert party.

The third change, relating to frustrating action, is new, though the consequences again bite only when shares are acquired.

The Code Committee has been advised that the existing presumptions of concertedness in the Code are not inconsistent with the Directive definition and can therefore be retained.

**(ii) Rule 9 dispensations**

The mandatory bid provision in Article 5.1 of the Directive is worded in such a way that the person making the bid is required to do so 'as a means of protecting the minority shareholders of the company'. Article 3.1(a) of the Directive (which will replace General Principle 1) also requires that 'if a person acquires control of a company, the other holders of securities must be protected'. As explained above, all dispensations from Rules must respect the Directive general principles and any dispensation from Rule 9 must therefore ensure that other shareholders are protected.

The Code Committee has been advised that whitewashes will still be permitted since independent shareholders are required to vote to approve the transaction and are therefore 'protected' in this way. However, other dispensations



currently contained in the Code may need amendment to ensure that minority shareholders will be protected if the dispensation is granted. The Code Committee will be considering all the existing Notes on dispensations from Rule 9 and will publish its detailed proposals with other Code amendments in 2005.

**(iii) Note 3 on Rule 9.5**

Article 5.4 requires all the circumstances and criteria which are relevant for determining any dispensation from the equitable price payable in respect of a mandatory bid to be set out. This will require Note 3 on Rule 9.5 to be amended to list all the circumstances and criteria which are relevant when the Panel grants a dispensation from the highest price.

**(iv) Rule 21 and frustrating action**

The DTI explains in its Consultation Document that Article 9, which deals with frustrating action, is optional but that it is the Government's intention that it should be applied in the UK through the Code. Article 9 is largely compatible with Rule 21.1, but there are certain differences, as detailed below. The Rule will, therefore, have to be amended.

The main difference between the two provisions is that the concept of frustrating action, which requires shareholder approval, is wider in Article 9 than in Rule 21.1. Article 9.2 refers to 'any action, other than seeking alternative bids, which may result in frustration of the bid'. Rule 21.1 is more specific, listing particular actions that require shareholder approval, though General Principle 7, which will be disappearing (see above and Appendix 3) has a wider scope. The Rule will therefore have to be broadened, to give it a more general application, but it seems likely that overall, there will be little change in the way in which the Rule will be applied. The specific actions currently listed in the Rule can be retained as examples.

However, another difference arises from Article 9.3. This provides that shareholders must approve any decision taken by the offeree board before it became aware that a bid was imminent and not yet partly or fully implemented,

if that decision does not form part of the normal course of business of the company and if its implementation might result in frustration of the bid. Under the last sentence of Rule 21.1, the Panel currently has the ability to waive the requirement for a shareholders' meeting if 'an obligation or other special circumstances exist'. This waiver will no longer be available.

**(v) Other minor changes**

There will also have to be a number of other minor changes. An example is that the time period for determining the price to be paid in a Rule 9 (mandatory) offer will have to be slightly different. At present, the Code looks back over the 12 month period before the commencement of the offer period, which might have been triggered by another, earlier bid. The Directive, in Article 5.4, looks at the period beginning not more than 12 months before the announcement of the mandatory offer. This might, therefore, be a shorter period in some cases.

## APPENDIX 1

### Article 3.1 of the Takeovers Directive

For the purpose of implementing this Directive, Member States shall ensure that the following principles are complied with:

- (a) all holders of the securities of an offeree company of the same class must be afforded equivalent treatment; moreover, if a person acquires control of a company, the other holders of securities must be protected;
- (b) the holders of the securities of an offeree company must have sufficient time and information to enable them to reach a properly informed decision on the bid; where it advises the holders of securities, the board of the offeree company must give its views on the effects of implementation of the bid on employment, conditions of employment and the locations of the company's places of business;
- (c) the board of an offeree company must act in the interest of the company as a whole and must not deny the holders of securities the opportunity to decide on the merits of the bid;
- (d) false markets must not be created in the securities of the offeree company, of the offeror company or of any other company concerned by the bid in such a way that the rise or fall of the prices of the securities becomes artificial and the normal functioning of the markets is distorted;
- (e) an offeror must announce a bid only after ensuring that he/she can fulfil in full any cash consideration, if such is offered, and after taking all reasonable measures to secure the implementation of any other type of consideration;
- (f) an offeree company must not be hindered in the conduct of its affairs for longer than is reasonable by a bid for its securities.

## APPENDIX 2

### **The Code General Principles**

1. All shareholders of the same class of an offeree company must be treated similarly by an offeror.
2. During the course of an offer, or when an offer is in contemplation, neither an offeror, nor the offeree company, nor any of their respective advisers may furnish information to some shareholders which is not made available to all shareholders. This principle does not apply to the furnishing of information in confidence by the offeree company to a bona fide potential offeror or vice versa.
3. An offeror should only announce an offer after the most careful and responsible consideration. Such an announcement should be made only when the offeror has every reason to believe that it can and will continue to be able to implement the offer: responsibility in this connection also rests on the financial adviser to the offeror.
4. Shareholders must be given sufficient information and advice to enable them to reach a properly informed decision and must have sufficient time to do so. No relevant information should be withheld from them.
5. Any document or advertisement addressed to shareholders containing information or advice from an offeror or the board of the offeree company or their respective advisers must, as is the case with a prospectus, be prepared with the highest standards of care and accuracy.
6. All parties to an offer must use every endeavour to prevent the creation of a false market in the securities of an offeror or the offeree company. Parties involved in offers must take care that statements are not made which may mislead shareholders or the market.

7. At no time after a bona fide offer has been communicated to the board of the offeree company, or after the board of the offeree company has reason to believe that a bona fide offer might be imminent, may any action be taken by the board of the offeree company in relation to the affairs of the company, without the approval of the shareholders in general meeting, which could effectively result in any bona fide offer being frustrated or in the shareholders being denied an opportunity to decide on its merits.
8. Rights of control must be exercised in good faith and the oppression of a minority is wholly unacceptable.
9. Directors of an offeror and the offeree company must always, in advising their shareholders, act only in their capacity as directors and not have regard to their personal or family shareholdings or to their personal relationships with the companies. It is the shareholders' interests taken as a whole, together with those of employees and creditors, which should be considered when the directors are giving advice to shareholders. Directors of the offeree company should give careful consideration before they enter into any commitment with an offeror (or anyone else) which would restrict their freedom to advise their shareholders in the future. Such commitments may give rise to conflicts of interest or result in a breach of the directors' fiduciary duties.
10. Where control of a company is acquired by a person, or persons acting in concert, a general offer to all other shareholders is normally required; a similar obligation may arise if control is consolidated. Where an acquisition is contemplated as a result of which a person may incur such an obligation, he must, before making the acquisition, ensure that he can and will continue to be able to implement such an offer.

### APPENDIX 3

#### **What happens to the Code General Principles (and parts thereof) that will disappear?**

**(i) General Principle 2**

The substance of General Principle 2 is broadly covered in Article 3.1(a), in terms of affording shareholders equivalent treatment. The more precise provisions of General Principle 2 are, however, largely reflected already in Rule 20.2 and Note 1 on that Rule. Some amendments may be made to the Rule to reflect more specifically elements of General Principle 2.

**(ii) General Principle 3**

The final sentence of General Principle 3 is replicated in Rule 2.5(a). The reference to an offer announcement being made only after ‘the most careful and responsible consideration’ can be incorporated in Rule 2.5(a).

**(iii) General Principle 5**

This is already reflected in Rule 19.1.

**(iv) General Principle 6**

The final sentence is essentially reflected already in Rule 19.3.

**(v) General Principle 7**

The parts of General Principle 7 which are not reflected in (Article 3.1(c) are to some extent already reflected in Rule 21.1, which will be amended further (see above).

**(vi) General Principle 8**

General Principle 8, which outlaws the oppression of minorities, is partially covered by General Principle 1 and Article 3.1(a). In practice, this principle has been cited in only a very small number of cases, nonetheless, the Code Committee considers it important that this underlying precept should continue to be reflected in the Code. It believes this will be achieved by Article 3.1(a) and by making it clear in the Introduction that the Code will apply to offers for minorities.

**(vii) General Principle 9**

The Code Committee considers that General Principle 9 is adequately provided for in the law on directors' fiduciary duties.

**(viii) General Principle 10**

The Code Committee considers that General Principle 10 is adequately reflected in Rule 9, Article 3.1(b) and Rule 2.5.

20 January 2005