

RS 10 Issued on 4 July 2002

THE PANEL ON TAKEOVERS AND MERGERS

**SHAREHOLDER ACTIVISM AND ACTING IN
CONCERT**

**STATEMENT BY THE CODE COMMITTEE OF THE
PANEL FOLLOWING THE EXTERNAL
CONSULTATION PROCESS ON PCP 10**

1. Introduction

On 14 March, the Code Committee of the Takeover Panel (“the Code Committee”) published a Public Consultation Paper (“PCP 10”) entitled “Shareholder Activism and Acting in Concert”. The purpose of this paper is to provide details of the Code Committee’s response to the external consultation process on PCP 10.

2. Number of responses received

A total of 15 responses were received from a range of parties, including from various fund management organisations and fund management representative associations.

3. Significant conflicts of views

Most respondents supported the implementation of the proposed changes to the Code set out in PCP 10. In particular, the responses received from fund management organisations and fund management associations, which are the entities most likely to be affected by the proposed changes, were substantially in favour of the proposals.

4. The Code Committee’s conclusions

4.1 General

- 4.1.1 The purpose of the proposed amendments to Note 2 on Rule 9.1 set out in PCP 10 was to clarify the circumstances in which activist shareholders and their supporters will be presumed by the Panel to be acting in concert and the period for which they will remain in concert. In each case, the Code Committee proposed that this should be determined by reference to a list of factors and that these factors should be set out in the Code.

- 4.1.2 Whilst not disagreeing with the factors listed, certain respondents made the point that the Panel must retain the ability to examine each case on its merits, taking account of all relevant facts. Such respondents questioned whether, by setting out a list of relevant factors in the Code, the Panel would be restricted from taking into account other factors which were significant in respect of the case in question. The Code Committee recognises that, on the subject of shareholder activism in particular, the Panel must retain the flexibility to examine all relevant facts. However, the Code Committee does not believe that this flexibility will be compromised by specifying a non-exhaustive list of factors which the Panel will take into account in addressing this subject. However, in order to emphasise that in each case the list of factors is non-exhaustive (and accordingly that in determining whether parties are acting in concert and when such parties may be taken out of concert, the Panel may take account of all relevant facts), a small change has been made to the fourth paragraph of Note 2 – see paragraph 4.6.1 of this Response Paper below.
- 4.1.3 Certain respondents were of the view that the proposals did not go far enough. In particular, two respondents questioned whether the dealing disclosure regime set out in Rule 8 should apply from the date of the announcement of the proposals until the conclusion of the relevant general meeting. At present, Rule 8 only applies during the course of an offer period. One respondent also suggested that the activist shareholders and the target company's board should be subject to an obligation akin to that set out in Rule 2 to announce the proposals in the event of the target company being the subject of rumour and speculation or there being an untoward movement in the price of its shares or if either party was seeking to approach more than a restricted number of shareholders.
- 4.1.4. The Code Committee is of the opinion that, in addressing the subject of shareholder activism, the sole consideration for the Panel is whether the shareholders' actions are such that they should be considered to be acting in concert and, if so, for what period. If the shareholders are ruled to be acting in concert, then the consequences should be only those which would normally apply under the Code. Accordingly, given that Rules 2 and 8 would not

normally apply in these circumstances, the Code Committee does not believe that it is appropriate for these provisions to be applied in the manner suggested. The Code Committee also notes that there may be a requirement for activist shareholders to disclose their dealings, both individually and collectively, under the Companies Act 1985.

4.2 Q1: Do you agree that the Code and the SARs need to be amended to address the implications of collective shareholder activism?

There was strong support for the proposition that the Code and the SARs should be amended to address the implications of collective shareholder activism.

4.3 Q2: Do you agree that the determination as to whether a proposal is board control-seeking should be carried out by reference to the list of factors suggested?

4.3.1 There was widespread support for the determination as to whether a proposal is board control-seeking to be carried out by reference to the list of factors suggested, particularly from the fund management organisations and the fund management representative associations.

4.3.2 Although there was general support for the proposition that the initial question should be whether there is any relationship between the activist shareholders and the proposed directors, two respondents considered this test to be too wide on the basis that (a) shareholders will usually only be willing to appoint persons known to them, and (b) there will generally only be a limited number of suitable candidates. The Code Committee acknowledges that whilst this may be the case, this test is not determinative of whether the proposal will be presumed to be board control-seeking; it simply means that the proposal *may* be board control-seeking, to be determined following an analysis of the other relevant factors. Furthermore, if the relationship between the activist shareholders and the proposed directors is insignificant, then the proposal will not be board control-seeking.

- 4.3.3 With regard to the other factors listed, one respondent was of the view that the key test should be whether control of the board will change as a result of the implementation of the proposals, regardless of whether there is any relationship between the activist shareholders and the proposed directors. This approach was considered but rejected by the Code Committee in PCP 10 for the reasons explained in paragraphs 3.2 to 3.4 of that Consultation Paper. Furthermore, in determining whether control of the board has changed, it is often not sufficient simply to take account of the number of directors replaced. As one respondent indicated, there may be cases where a proposal to change a very limited number of directors should be considered to be board control-seeking. For example, although it is acknowledged in paragraph 4.4(b) of PCP 10 that a proposal to change only one director will not normally be considered to be board control-seeking, this conclusion may not be appropriate where it is proposed to replace the joint chairman and chief executive on a small board.
- 4.3.4 Another respondent was of the view that the key test should be whether the activist shareholders will benefit as a result of the implementation of the proposal other than as a result of their holding shares (factor (e) set out in Note 2). Whilst the Code Committee considers this to be a relevant factor, it does not believe that it is appropriate for this to be the determinative factor on the basis that it will often not be clear, particularly at the outset, whether this will be the case.
- 4.3.5 Accordingly, given the general support for the proposals set out in the Consultation Paper, particularly from the fund management community, the Code Committee has adopted the test set out in PCP 10 for determining whether a proposal is board control-seeking, subject to a few small changes explained below.
- 4.3.6 Three respondents noted that the draft Note 2 on Rule 9.1 focuses on activist shareholders requisitioning an extraordinary general meeting for their proposals to be considered by the company's shareholders as a whole and

questioned whether the Panel ought to adopt a similar approach to the requisitioning by activist shareholders of the consideration of their proposals at the company's annual general meeting. The Code Committee agrees that there should be no distinction between the consideration of a board control-seeking proposal at a specially requisitioned extraordinary general meeting and the consideration of such a proposal at the company's annual general meeting and, in order to make this clear, the Code Committee has amended the second sentence of Note 2 as follows:

“However, the Panel will normally presume shareholders who requisition or threaten to requisition the consideration of a board control-seeking proposal either at an annual general meeting or at an extraordinary general meeting, in each case together with their supporters as at the date of the requisition or threat, to be acting in concert with each other and with the proposed directors.”

- 4.3.7 In the light of comments made by two respondents as to whether the word “deem” or “deemed” was appropriate on the basis that it suggested that such deemings might not be capable of rebuttal, a few small changes have been made to Note 2 to reflect this point. As a result, all references to “deem” or “deemed” in Note 2 have been removed.
- 4.3.8 One respondent questioned whether certain proposals should be considered to be board control-seeking albeit that they do not involve a change to the company's board – for example, a proposal that the company should sell one of its businesses and return the cash proceeds to shareholders. The Code Committee addressed this subject in paragraph 4.5 of PCP 10 and suggested that the determination as to whether such a proposal should be considered to be board control-seeking should be by reference to whether the activist shareholders threaten, either explicitly or implicitly, to make changes to the board of the company if their proposals are not implemented. If they do, then the analysis set out in Note 2 is to be applied to the threat. If no threat, either explicit or implicit, is made to make changes to the board, then the directors will continue to be in charge of the management of the company such that, in

the opinion of the Code Committee, it would be inappropriate for the Panel to dictate that a particular proposal, whatever its nature, should be regarded in or of itself to be board control-seeking. However, as indicated above, each case will need to be considered on its facts.

4.3.9 Two respondents noted that if the activist shareholders already have representatives on the board of a company, such shareholders could obtain control of the board by simply removing certain of the existing directors. The Code Committee agrees with this and believes that, taking account of the factor set out in paragraph (f), the spirit of Note 2 is clear that such proposals should be considered to be board control-seeking. Accordingly, the Code Committee does not believe that any amendment is required to Note 2 on account of this.

4.3.10 One respondent suggested that the timing of a proposal by shareholders to make changes to a company's board may also be a relevant factor. For example, the Panel may be more inclined to consider such a proposal to be board control-seeking if the company is at that time subject to an offer. The Code Committee agrees with this but, again, believes that no amendment is required to Note 2 to reflect this.

4.4 Q3: In the light of the approach proposed to be adopted in respect of non-investment trust companies, do you agree with the approach proposed to be adopted in respect of investment trust companies?

4.4.1 Although most respondents were in favour of adopting the approach set out in PCP 10 in respect of investment trust companies, representatives of the investment trust community pointed out that, because control of an investment trust company rests exclusively with the company's board, a proposal simply to replace the investment manager should never be considered to be board control-seeking, even in cases where there may be a relationship between the proposed investment manager and one or more of the activist shareholders. Accordingly, it was suggested that the reference to “/or” in line 2 of paragraph 4.7 of PCP 10 was incorrect and should, therefore, also be deleted

from the first line of the third paragraph of Note 2. The Code Committee agrees with this and Note 2 has been amended accordingly.

4.4.2 The same respondent also took the view that, for the reasons explained above, investment trust companies should effectively be treated in the same way as non-investment trust companies such that the sole focus should be on the proposed changes to the company's board and no account should be taken of whether it is proposed to replace the investment manager and, if so, the identity of the proposed investment manager. The Code Committee does not agree with this and believes that the identity of the proposed investment manager (if any) should be retained as a relevant factor to be applied in appropriate cases.

4.5 Q4: Do you agree that shareholders who back or support a board control-seeking proposal, together with the proposed directors, should be presumed to have come into concert once an agreement or understanding is reached between them in respect of a board control-seeking proposal?

4.5.1 There was general agreement, particularly from the fund management community, that shareholders who back or support a board control-seeking proposal should be presumed (as opposed to "deemed" – see paragraph 4.3.7 above) to have come into concert once an agreement or understanding is reached between them in respect of a board control-seeking proposal.

4.5.2 Three respondents questioned whether it was correct to include in the concert party persons who give their support to the activist shareholders prior to the date of the requisition. The Code Committee considers that, in accordance with current practice, it is extremely important that such persons are included in the concert party as the giving of such support to a board control-seeking proposal goes to the very heart of the concept of acting in concert.

4.5.3 One respondent referred to a case in which a shareholder action group comprising over 1,000 shareholders requisitioned an extraordinary general meeting to seek board representation and questioned whether it was really

appropriate ever to regard such a large group of persons to be acting in concert. The Code Committee does not believe that it should be prescriptive on such a question. This would be a matter for the Executive (or, if appropriate, the Panel) to determine taking account of all relevant facts.

- 4.5.4 One respondent believed that it would be helpful for Note 2 to make clear the potential consequences of being ruled to be acting in concert. The Code Committee agrees with this and, accordingly, has amended the final sentence of the first paragraph of Note 2 as follows:

“Such parties will be presumed to have come into concert once an agreement or understanding is reached between them in respect of a board control-seeking proposal with the result that subsequent purchases of shares by any member of the group could give rise to an offer obligation.”

4.6 Q5: Do you agree that an analysis of the factors listed is the correct way of determining when such parties should be taken out of concert?

- 4.6.1 The majority of respondents, including the fund management representative associations, agreed that the correct way of determining when such parties should be taken out of concert was by reference to the list of factors set out in PCP 10, provided that, as discussed above, the Panel should not be prevented from taking account of any other relevant facts. Accordingly, in order to make clear that the list of factors set out in paragraph 4.11 of PCP 10 is not exhaustive, the Code Committee has amended the beginning of the fourth paragraph of Note 2 as follows:

“In determining whether it is appropriate for such parties to be held no longer to be acting in concert, the Panel will take account of a number of factors, including the following:”

- 4.6.2 Two respondents were of the view that the parties should be taken out of concert once the board changes have occurred as the activist shareholders will then have achieved their stated objective. As explained in PCP 10, the Code

Committee believes that it is not appropriate for the concert party automatically to be disbanded at this time given that, by definition, the parties will then have obtained control of the company's board.

4.6.3 Certain respondents enquired as to the relationship between Note 1 on the definition of acting in concert and the factors set out in the fourth paragraph of Note 2 on Rule 9.1. The Code Committee confirms that the general principle set out in Note 1 on the definition of acting in concert that it would be necessary for clear evidence to be presented to the Panel before it will rule that parties are no longer acting in concert sets out the overriding policy in this area. However, the Code Committee does not believe that this needs to be explicitly stated in Note 2 on Rule 9.1.

4.6.4 One respondent suggested whether another relevant factor should be the actions taken by the activist shareholders with regard to their shareholdings. For example, if one of the activist shareholders disposed of all of his shares following an unsuccessful extraordinary general meeting, that would suggest that he should no longer be considered to be part of the concert party. The Code Committee agrees with this analysis but believes that this point is already addressed in factor (c) in the fourth paragraph of Note 2 (whether there is any evidence of an ongoing struggle between the activist shareholders and the board of the company).

4.7 Implications for SAR 5

One respondent made the observation that it would be strange to add a new Note to SAR 5 making specific reference to the particular activities described in the revised Note 2 on Rule 9.1 and, as proposed in PCP 9, in the new Note 5 on Rule 9.1. The inclusion of such specific references might, in the respondent's opinion, give the impression that persons who are presumed to be acting in concert for other reasons under the Code might not be considered to be acting 'by agreement or understanding' for the purpose of SAR 5. The Code Committee accepts that such an inference could be drawn from the proposed Note 5 on SAR 5 and that this would be undesirable. Accordingly,

the Note will not be added. However, practitioners should be aware that, by virtue of SAR 5, the SARs will be relevant to activist shareholders and their supporters.

5. Amendment to the Code

The Appendix to this document sets out in full the text of the revised Note 2 on Rule 9.1, as amended by the further changes discussed in this statement.

APPENDIX

Rule 9.1

NOTES ON RULE 9.1

2. *Collective shareholder action*

The Panel does not normally regard the action of shareholders voting together on a particular resolution as action which of itself indicates that such parties are acting in concert. However, the Panel will normally presume shareholders who requisition or threaten to requisition the consideration of a board control-seeking proposal either at an annual general meeting or at an extraordinary general meeting, in each case together with their supporters as at the date of the requisition or threat, to be acting in concert with each other and with the proposed directors. Such parties will be presumed to have come into concert once an agreement or understanding is reached between them in respect of a board control-seeking proposal with the result that subsequent purchases of shares by any member of the group could give rise to an offer obligation.

In determining whether a proposal is board control-seeking, the Panel will have regard to a number of factors, including the following:

- (a) the relationship between any of the proposed directors and any of the shareholders proposing or supporting them. Relevant factors in this regard will include:*
 - (i) whether there is or has been any prior relationship between any of the activist shareholders and any of the proposed directors;*
 - (ii) whether there are any agreements, arrangements or understandings between any of the activist shareholders and*

any of the proposed directors with regard to their proposed appointment; and

- (iii) whether any of the proposed directors will be remunerated in any way by any of the activist shareholders as a result of or following their appointment.*

If, on this analysis, there is no relationship between any of the proposed directors and any of the activist shareholders, or if any such relationship is insignificant, then the proposal will not be considered to be board control-seeking such that the parties will not be presumed to be acting in concert and it will not be necessary for the factors set out at paragraphs (b) to (f) below to be considered. If, however, such a relationship does exist which is not insignificant, then the proposal may be considered to be board control-seeking, depending on the application of the factors set out at paragraph (b) below or, if appropriate, paragraphs (b) to (f) below;

- (b) the number of directors to be appointed or replaced compared with the total size of the board.*

If it is proposed to appoint or replace only one director, then the proposal will not normally be considered to be board control-seeking. If it is proposed to replace the entire board, or if the implementation of the proposal would result in the proposed directors representing a majority of the directors on the board, then the proposal will normally be considered to be board control-seeking.

If, however, the implementation of the proposal would not result in the proposed directors representing a majority of the directors on the board, then the proposal will not normally be considered to be board control-seeking unless an analysis of the factors set out at paragraphs (c) to (f) below would indicate otherwise;

- (c) *the board positions held by the directors being replaced and to be held by the proposed directors;*
- (d) *the nature of the mandate, if any, for the proposed directors;*
- (e) *whether any of the activist shareholders will benefit, either directly or indirectly, as a result of the implementation of the proposal other than through its holding of shares in the company; and*
- (f) *the relationship between the proposed directors and the existing directors and/or the relationship between the existing directors and the activist shareholders.*

In respect of a proposal to replace some or all of the directors and the investment manager of an investment trust company, the relationship between the proposed new investment manager and any of the activist shareholders will also be relevant to the analysis of the factors set out at paragraph (a) above and, if appropriate, paragraphs (c) to (f) above.

In determining whether it is appropriate for such parties to be held no longer to be acting in concert, the Panel will take account of a number of factors, including the following:

- (a) *whether the parties have been successful in achieving their stated objective;*
- (b) *whether there is any evidence to indicate that the parties should continue to be held to be acting in concert;*
- (c) *whether there is any evidence of an ongoing struggle between the activist shareholders and the board of the company;*
- (d) *the types of activist shareholders involved and the relationship between them; and*

- (e) *the relationship between the activist shareholders and the proposed/new directors.*