A View from London: The UK Takeover Code ? Recent Changes

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Introduction

In the UK, the conduct of **public takeovers** and certain private transactions is governed by the **City Code on Takeovers and Mergers** (the Code). The Code is a set of statutory rules and general principles which have at their heart the objective of ensuring fair treatment for all shareholders in takeover bids and avoiding the creation of false markets. The Code is issued and administered by the Panel on Takeovers and Mergers (the Panel), an independent body comprised of investors, practitioners and members of major financial and business institutions.

With effect from 30 September 2013, the Code was amended and as a result now has application to a wider category of companies and transactions. The Code now applies to all public companies that are incorporated in the United Kingdom, the Isle of Man and the Channel Islands and whose shares are traded on a regulated market in the United Kingdom, any stock exchange in the Isle of Man or the Channel Islands or any multilateral trading facility in the United Kingdom, irrespective of where these companies are managed and controlled, thereby implementing the partial removal of the so?called "residency test".

The position under the Code prior to 30 September 2013

Prior to 30 September 2013, the Code applied to all companies incorporated in the UK, the Isle of Man or the Channel Islands whose shares were traded on a regulated market in the United Kingdom (i.e. the London Stock Exchange's main market for listed securities) or on a stock exchange in the Isle of Man or the Channel Islands. In addition, if a company did not have its shares admitted to trading on such a market but was a public limited company or a private company whose securities had been admitted to trading in the previous 10 years, it would be subject to the Code if it satisfied the residency test (i.e. its place of management and control was within the UK, the Isle of Man or the Channel Islands). In applying the residency test, the Panel has taken into consideration factors such as the place of residence of the majority of a company's board of directors.

What exactly is changing?

The changes to the Code go to the very essence of the Code, namely which companies and transactions are subject to it. The residency test has now been removed for companies incorporated in the UK, the Isle of Man or the Channel Islands whose shares are traded on multilateral trading facilities (such as AIM or the ISDX Growth Market).

It was sometimes complex to identify whether or not a company listed on a UK stock market was subject to the auspices of the Code because, for example an AIM company whose management was based outside of the UK (even if it had a registered office in the UK, the Isle of Man or the Channel Islands) fell outside the jurisdiction of the Panel. Shareholders could not simply look to the place of incorporation of the relevant company, but would need to look beyond to the question of place of management/ residence of directors, which was not always clear. This led to concern and uncertainty on the part of holders of shares in AIM companies who expected to automatically benefit from the protections afforded by the provisions of the Code, but were denied because of the application of the residency test.

The changes bring the Panel's approach to companies listed on AIM or the ISDX Growth Market in line with companies whose shares are listed on the London Stock Exchange's main market for listed securities. By the Panel’s estimation, there are approximately 200 additional listed companies which will now fall within the Code’s jurisdiction as a result of these changes. It will be interesting to see whether any overseas?managed companies seeking to join AIM will attempt to avoid being brought within the jurisdiction of the Code by listing a non?UK top company instead. The Code will continue to not apply to open?ended investment companies.

Who is the residency test being retained for?

The residency test remains in place for non?traded public companies, private companies that potentially may be subject to the Code because they have had securities admitted to trading within the preceding 10 years or public companies whose shares are admitted to trading on a public market that is not a regulated market (either in the UK or, for UK companies only, in another EEA member state) or a multilateral trading facility in the UK or a stock exchange in the Channel Islands or Isle of Man. This means that the Code only applies to UK, Isle of Man and Channel Islands companies with shares admitted to trading outside the EEA where such companies satisfy the residency test. AIM?listed companies which are incorporated in jurisdictions such as the Cayman Islands are still not subject to the Code even if they would like the Code to apply to them.

The table set out below illustrates which companies are now subject to the Code:

	Company	Will The Code Apply?
1	UK, Isle of Man or Channel Islands incorporated company with securities admitted to trading on a multilateral trading facility in the UK such as AIM.	The Code will apply to these companies without reference to the residency test.
2	Company with securities admitted to trading on a regulated market in the UK such as the main market of the London Stock Exchange or Channel Island or Isle of Man stock exchange.	The Code will continue to apply to these companies without reference to any residency test.

3	Company with securities admitted to trading on an EEA regulated market (but not a UK regulated market).	This is subject to the rules on shared jurisdiction and the residency test is not relevant.
4	Company with securities admitted to trading on a public market other than company referred to in 1, 2 or 3 above such as the NYSE.	The residency test will continue to be relevant for these companies ? the Code will apply if the residency test is satisfied.
5	Public company whose securities are not admitted to trading on a public market.	The residency test will continue to be relevant for these companies – the Code will apply if the residency test is satisfied.
6	Private company.	The residency test will continue to be relevant for these companies, and the Code will apply if: • The residency test; and • The “10 year rule” referred to above

What are the practical implications of these changes for companies becoming subject to the Code?

A number of companies may have provisions in their articles of association which seek to replicate certain provisions of the Code. If this is the case, these provisions may have ceased to be relevant or may conflict with the Code from 30 September 2013 onwards. If there is a direct conflict between a company's articles of association and the Code, or the relevant clauses of the articles of association become obsolete, because they are, for example, expressed to apply only in instances where the Code does not apply, the relevant clauses will need to be removed by shareholder resolution at the next available opportunity.

Directors of companies that are now subject to the Code will need to familiarise themselves with the provisions of the Code, particularly in the context of potential offers for their shares. The Code stresses the vital importance of secrecy, particularly in relation to confidential and price?sensitive information, before an announcement is made and also the need for all parties to act in such a way so as to reduce the possibility of any accidental leakage of information. The Code also sets out very detailed rules as to when announcements are required to be made. Announcements will be required when, following an approach by or on behalf of a potential offeror, there is an untoward movement in the share price of the offeree or the offeree company is the subject of press speculation.

Investors in companies that fall within the auspices of the Code will now be unable to increase their shareholdings over the threshold of 30% or, if they already hold between 30% and 50% of a company's shares, they will be unable to increase their shareholding at all without being obliged to make a mandatory bid for the remaining share capital in the company, unless they manage to obtain a waiver from the Panel and the consent of the independent shareholders of the company. If a company has convertible securities in issue, the exercise of these could also trigger a mandatory offer under the Code.

Code amendments to profit forecasts, material changes in information and quantified financial benefits statements

Amendments to the Code relating to profit forecasts, material changes in information and quantified financial benefits statements also came into effect on 30 September 2013.

The amendments to the Code are intended to provide greater clarity for offerees and offerors that publish profit forecasts before an offer is made and during the offer period. The rationale behind the new provisions appears to be to apply more proportionate requirements in respect of profit forecasts, therefore encouraging a greater degree of communication with the market and with a company's shareholders and to ensure a greater degree of consistency with the existing reporting framework that applies to profit forecasts, namely the Prospectus Rules published by the Financial Conduct Authority.

Key amendments

- The concept of a "quantified financial benefits statement" has been introduced to Rule 28 of the Code replacing the previous concept of a "merger benefits statement". The Financial Reporting Council intends to publish a new reporting standard on quantified financial benefits statements and their "proper compilation" in due course.
- A new directors’ confirmation regime will apply to profit forecasts published by parties following the first active consideration of an offer and prior to an approach to the offeree company.
- Dispensations from the requirements of Rule 28 may be available where the application of the rule would be inappropriate or disproportionate; for example, where consideration securities will not represent a material proportion of the offeror’s enlarged share capital or a material proportion of the value of the offer.
- The new Rule 27 contains a new obligation on parties to announce “material new information” that they would have been required to include in the offer documentation, had such information been known when the relevant documentation was published.

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