UK Takeover Code Changes: Key Points For Bidders, Targets

By **Dan Hirschovits, Will Pearce and Joseph Scrace** (December 13, 2023)

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In keeping with its practice of revisiting the U.K. Takeover Code in light of market practice,[1] the U.K. Takeover Panel consulted on proposed changes to Rule 21 in May,[2] and confirmed the amendments in October. These amendments took effect on Dec. 11.

Rule 21 of the code regulates the actions a target company can and cannot take in order to ensure offers or possible offers for it by a bidder are not frustrated. In the U.K., targets have limited defensive measures at their disposal, and a bidder is always free to go to target shareholders directly.

Rule 21.1: Increased Flexibility for Target Companies During Offers

The Restriction

Rule 21.1 of the code continues to seek to prevent a target taking actions that might frustrate an offer. In short, it provides that during a relevant period a target may not take a restricted action or any other action that may result in the frustration of an offer or possible offer, without the consent of the panel or shareholder approval.

The Relevant Period

The relevant period lasts from when the target receives an approach or when an offer period starts, whichever is earlier, until the end of the offer period or, if no offer period begins, the seventh day following the date on which the target unequivocally rejects the latest approach, subject to specific rules for competitive and formal sales processes.

Restricted Actions

The panel has sought to keep Rule 21.1 within its intended purpose and not prohibit actions that are unlikely to frustrate an offer or hinder a target in its ordinary course of business, particularly a target whose business involves buying and selling assets. Accordingly, the code now provides that in order to be a restricted action:

- Any disposition or acquisition of assets by a target must be of a material amount, and outside the ordinary course of its business;
- Any entry into, amendment or termination of a contract by a target must be in respect of a material contract, and outside the ordinary course of its business; and
- Any issue of shares or convertibles, grant of options or awards, or redemption or buyback of shares or convertibles by a target must be outside the ordinary course of its business.

Note that no materiality test is applied to changes in a target's share capital, and changes of any amount outside the ordinary course of its business are restricted.

In determining if grants made under incentive arrangements are within the ordinary course of a target's business, the panel will look at the target's normal practice under established schemes, prior public disclosure of its proposed practice in respect of new schemes, and whether grants are being made in connection with a genuine promotion or hire.

The panel will normally consider issues of new shares to satisfy the exercise of options or awards as within the ordinary course of business, although any decision by a target to accelerate vesting of options or awards may change this.

Any target share buybacks or redemptions will need to be in line with defined limits announced or established before the relevant period in order for them to be considered within the ordinary course of business.

The Panel

The panel has amended and supplemented the notes to Rule 21.1 — including notes on how it will assess whether a disposal, acquisition or contract is material or within the ordinary course of business, and whether a change in a target's share capital is within the ordinary course of business.

An assessment of whether a disposal, acquisition or contract is material or within the ordinary course of business should always be considered by the target objectively on its own facts. The panel has made it clear that a target should still consult the panel if any action it is considering may be restricted, even if the target itself is of the view that the relevant action is within the ordinary course of business.

New Practice Statement 34 will, therefore, be a key source for market participants who can use it to check their own views against a number of factors the panel may take into account in reaching its conclusion. These include:

- For asset disposals and acquisitions for cash, if the transaction is within an established business model, if the valuation is in line with normal market practice or the target's prior practice, and if it is part of an ongoing strategy;

- For disposals and acquisitions of assets for shares or convertibles, if the target has issued shares or convertibles as consideration before, and how frequently; and if the proposed issue is at market value or of a material size, and how this compares to any past issues; and

- With respect to entering into, amending or terminating a contract, how the contract compares in size to the target's other contracts and, if it is relatively material to such other contracts, whether similar contracts have been entered into before, and how frequently, if it is an important contract, and if the costs of terminating or amending it are consequential. Maintenance capital expenditure, compared to new growth capital expenditure, refinancing or raising debt on normal market terms and settling commercial disputes will all normally be regarded as within the ordinary course of business.

Panel Consent to an Action

The circumstances in which the panel will normally consent to an action being taken by a target remain substantially the same as before — i.e., the action is conditional on the offer being withdrawn or lapsing, the bidder consents to the action, holders of more than 50% of voting rights state in writing that they approve of the action, or the action is taken pursuant to a contract entered into, or has been partially implemented, before the relevant period.

Reverse Takeovers

Rule 21.1 now applies to a bidder in a reverse takeover as if the bidder were a target. This is a helpful change and allows the parties to a reverse takeover to more easily achieve what they had been doing in practice before the rule change.

It had previously been necessary to impose restrictions equivalent to Rule 21.1 on the bidder via contract, alongside a dispensation from the offer-related arrangement provisions of the code, as they apply to reverse takeovers.

Sanctioning a Scheme in a Competitive Situation

The panel will consent to Rule 21.1(a) not applying, other than in exceptional circumstances, e.g., the target is acting in a clearly unreasonable manner, but not that the sanction of the lower offer is being sought or that the competing bidder has only had limited time to consider its offer, where the target seeks to sanction a scheme in a competitive situation.

The market uncertainty on this point raised in prior consultations has, therefore, helpfully been addressed, and the logic behind the change makes sense — that logic being, briefly, that there are already a number of protections for target shareholders in the court sanction process, and the panel retaining a wider power to intervene may cause uncertainty.

Rule 21.3: Competing Bidders No Longer Required to Request Target Information Provided to Another Bidder

Rule 21.3 seeks to ensure that a target provides each competing bidder with the same information.

Prior to response statement amendments, a bidder could not ask a target to provide it with all information it had provided to a competing bidder in general terms. This resulted in a practice of long, complex, specific daily information request lists having to be produced by a bidder and responded to by a target.

As amended, Rule 21.3 now permits a bidder to ask for such information in general terms, and requires that the target company provide all information provided to another bidder, both at the time of the request, and in the seven days following, which will remove the need for a daily request.

This is a pragmatic reduction to the administrative burden of the parties involved in an offer, particularly targets and their advisers, which are often already at capacity seeking to execute a takeover while running their respective businesses.

Concluding Thoughts

Like most of the respondents to the panel's consultation paper, we are generally supportive of the amendments.

Changes that ensure that Rule 21.1 does not go beyond its purpose of prohibiting frustrating action, and that remove legal and administrative constraints on a target operating its business in the ordinary course during an offer, are likely to be welcomed by both targets and bidders — or if not welcomed by bidders, not considered objectionable.

The additional clarity in the notes to the new rules, and in practice statement 34, should allow targets to identify prohibited actions more easily — and, if an action needs to be taken and there is a requirement to consult the panel, should allow them to go into such discussions on a more informed basis. This should save time for all concerned.

Finally, as a general comment, the amendments to Rule 21.1 of the code are a good example of how the panel can relatively quickly and efficiently adapt the code to address inefficiencies, and ensure that in ever-changing market conditions, the process for takeovers in the U.K. continues to function properly for bidders, targets and shareholders.

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[1] Response Statement 2023/1.

[2] Public Consultation Paper 2023/1.