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Takeover Panel publishes three consultation papers (on profit forecasts, merger benefits statements and material changes in information; issues relating to pension scheme trustees; and companies subject to the Takeover Code).

1. Introduction

On 5 July 2012, the Code Committee of the Takeover Panel (the "Code Committee") published three consultation papers inviting comments on proposed amendments to the Takeover Code (the "Code"). The first paper sets out the Code Committee's proposals for amendments to the provisions of the Code which relate to profit forecasts, merger benefits statements and material changes in information previously published during an offer period[1]. The second paper examines certain issues relating to pension scheme trustees and sets out the Code Committee's proposals to extend the provisions of the Code that apply to employee representatives to apply also to the trustees of the offeree company's pension schemes. The third paper is concerned with the companies to which the Code applies and principally deals with the Code Committee's proposal to remove the residency test from the rules that determine the companies to which the Code applies. Responses to all three consultation papers are requested by 28 September 2012.

2. Consultation on profit forecasts, merger benefits statements and material changes in information

2.1 *Profit forecasts*

[1] On 5 March 2010, the Code Committee published a consultation paper on proposed amendments to the provisions of the Code relating to profit forecasts, asset valuations and merger benefits statements. The Code Committee received a number of responses to this consultation and the Panel Executive subsequently met with a number of the respondents to discuss the issues raised. However, the process was put on hold following the Code Committee's review of certain aspects of the Code following the takeover of Cadbury plc by Kraft Foods Inc. The proposals in the 5 March 2010 consultation relating to profit forecasts and merger benefit statements have now been superseded by the proposals in the consultation published on 5 July 2012. The Code Committee intends to publish a separate consultation on proposed amendments in relation to asset valuations following a more comprehensive review of this area by the Panel Executive and the finalisation of the amendments relating to profit forecasts and merger benefits statements.

Rule 28 of the Code provides that profit forecasts must be compiled with due care and consideration by the directors of a company. Rule 28 currently requires that, if a profit forecast is published by an offeree company or an offeror (other than an offeror offering solely cash) during an offer period, then (a) the assumptions on which the profit forecast is based must be stated, and (b) the relevant party must obtain and publish reports on the profit forecast from its reporting accountants and any financial advisers mentioned in the document. Rule 28 further provides that any profit forecast which has been published by an offeree company or an offeror (other than an offeror offering solely cash) before the commencement of the offer period must be repeated in the offeree board circular or the offer document (as the case may be), with the effect that it will be subject to the requirements to state the assumptions on which it is based and obtain reports from accountants and financial advisers.

The Code Committee is concerned that the existing requirement to obtain reports on profit forecasts made before the commencement of the offer period might have the effect, in circumstances where there is no reason to believe that an offer is in contemplation, of either deterring companies from publishing forward-looking guidance on future expected profits, which guidance might be useful for shareholders and other market participants (and which is commonly provided in various overseas jurisdictions), or encouraging companies, which would otherwise wish to publish a profit forecast, to give forward-looking guidance using language intended to circumvent the requirements of Rule 28. Whilst the Code Committee is not in favour of excluding such profit forecasts from the scope of Rule 28 altogether (on the basis that shareholders and other market participants are likely to place particular reliance on an outstanding profit forecast in the context of an offer) it believes it is desirable to amend Rule 28 to provide a more proportionate approach.

The Code Committee proposes introducing a revised Rule 28 with the stated aims of (a) applying more proportionate requirements than at present to certain profit forecasts, including, in particular, profit forecasts which have been published before an approach with regard to a possible offer has been made; (b) adopting a more logical framework for the regulation of profit forecasts than the current Rule 28; and (c) achieving a greater consistency with other legislation, standards and guidance than is currently the case.

The Code Committee's main proposals for the revision of Rule 28 are:

- introducing definitions of "profit forecasts" and "profit estimates" that are consistent with (although not identical to) the definitions of those terms included in the Prospectus Directive and the FSA Handbook;

- removing the current requirement to obtain reports from reporting accountants and financial advisers in respect of profit forecasts published before an approach with regard to a possible offer is made (a "Pre-Approach Profit Forecast");

- introducing, in respect of any Pre-Approach Profit Forecast, a new requirement that the offer document or offeree board circular (as appropriate) should either:

  (i) repeat the Pre-Approach Profit Forecast and include confirmations by the directors that the Pre-Approach Profit Forecast remains valid and that the basis of accounting is consistent with the company's accounting polices (as well as state the assumptions on which the Pre-Approach Profit Forecast was based and the details of the basis on which it was compiled); or

  (ii) include a statement by the directors that the Pre-Approach Profit Forecast is no longer valid, together with an explanation of why this is the case; or

  (iii) include a new profit forecast for the relevant period (although this will trigger the requirements that are applicable to profit forecasts published during the offer period, including the requirement to obtain reports);

- providing the Panel with the express power to grant a dispensation from the requirements of Rule 28 in circumstances where:

  (i) a profit forecast is published by a party to an offer in the ordinary course of its communications with its shareholders and the market and in accordance with an established practice (e.g., earnings guidance); or

  (ii) the profit forecast relates to a period ending more than 15 months from the date on which it is first published; or

  (iii) the offer could not result in the issue of securities representing 10% or more of the enlarged equity share capital of the offeror and the Panel regards the application of Rule 28 as disproportionate; or

  (iv) a profit forecast states a maximum figure for the likely level of profits for a particular period;

- introducing a requirement that, if, during an offer period, a party to an offer publishes or repeats a profit forecast for a future financial year, that party must also publish corresponding profit forecasts for the current financial year and any intervening financial years;

- introducing a note to clarify that the reporting requirements will apply where the offer is a management buy-out or similar transaction or is being made by the existing controller or group of controllers, unless the Panel agrees otherwise; and

- introducing a new provision to clarify that Rule 28 applies to a profit forecast which relates to a part of a business of a party to an offer, unless the Panel agrees otherwise;

2.2 *Merger benefits statements*

Rule 19.1 of the Code requires that each document published, or statement made, during the course of an offer must be prepared with the highest standards of care and accuracy and the information given must be adequately and fairly presented. Where a party to the offer makes quantified statements about the expected financial benefits of a proposed takeover or merger (so-called "merger benefits" statements), Note 9 on Rule 19.1 currently imposes certain additional requirements,[2] but provides that these additional requirements will only need to be complied with in securities exchange offers (i.e., not in cash-only offers) and will not normally apply in the case of a recommended securities exchange offer unless a competing offer is made and the merger benefits statement is subsequently repeated by the party which made it or the statement otherwise becomes a material issue.

The Code Committee proposes reformulating Note 9 to Rule 19.1 to extend its scope and align its reporting requirements with those that apply to profit forecasts. The new provision (which would be incorporated into the Code as a new Rule 28.5) would apply to "quantified financial benefits statements". This new definition would cover not only quantified statements about the expected financial benefits if a takeover goes ahead, but would also extend to statements by the offeree company quantifying any financial benefits expected to arise from cost saving measures and/or an alternative transaction proposed to be implemented if the offer does not go ahead. The Code Committee also proposes that the requirements in relation to reports and the stating of assumptions that apply to profit forecasts should apply equally to quantified financial benefits statements.

Finally, the Code Committee considers that the exemption from the requirements of Note 9 on Rule 19.1 that currently applies where the offer is recommended should not be retained. As such, under the new Rule 28.5 proposed by the Code Committee, the enhanced reporting requirements will apply to quantified financial benefits statements regardless of

[2] Namely, that the party to the offer must publish (a) the bases of the belief (including sources of information) supporting the statement; (b) reports by financial advisers and accountants that the statement has been made with due care and consideration; (c) an analysis and explanation of the constituent elements sufficient to enable the relative importance of these elements to be understood; and (d) a base figure for any comparison drawn.

whether the offer is hostile or recommended (although the Code Committee confirms that cash-only offers should continue to be out-of-scope of this Rule).

2.3 *Material changes to information*

Rule 27 of the Code currently provides that the parties to an offer are only required to disclose details of any material change in information published in an offer document or an offeree board circular in the event that they publish a subsequent document. Where no subsequent document is published, there is currently no specific requirement for a party to an offer to disclose details of any material changes in information which it has previously published.

To address this failing in the Code, the Code Committee proposes amending Rule 27 of the Code to require that an offeror and the offeree company must promptly announce any material changes in information published in the offer document and the offeree board circular respectively. This obligation will apply until the end of the offer period, but will not continue thereafter. The Panel will also be given the ability to require the relevant party to publish a document setting out details of any material changes to previously published information, rather than just making an announcement.

Where an offeror or the offeree company publishes any subsequent document in connection with the offer, they will continue to be required to include in that document details of any material changes in information previously published or a statement that there have been no such material changes. However, the Code Committee proposes expanding the list of matters which must be updated in this way (for example to include any updates of profit forecasts).

2.4 *Other amendments*

Although the consultation paper mainly focuses on profit forecasts, quantified financial benefits statements and material changes in information, the Code Committee also proposes various other minor and consequential amendments to the Code relating to documents published by an offeror and the offeree company.

3. Consultation on issues relating to pension scheme trustees

The takeover of Cadbury plc by Kraft Foods Inc triggered an extensive review of the Code. During the public consultation process, the Code Committee received a number of responses from pension scheme trustees and their advisers suggesting that the provisions of the Code which relate to the employee representatives of the offeree company should be extended so as to apply also to the trustees of the offeree company's pension schemes.

In the consultation paper on this issue published on 5 July 2012, the Code Committee confirms that, on balance, it is in favour of extending the provisions of the Code which

apply to employee representatives to the pension trustees and proposes the following amendments to put this into effect:

3.1 *Disclosure by an offeror of its intentions*

In order to facilitate a debate on the effects of an offer on the offeree company's pension schemes during the course of the offer, the Code Committee proposes introducing a requirement for an offeror to state in the offer document (a) its intentions with regard to the offeree company's pension schemes, and (b) the likely repercussions of its strategic plans for the offeree company on the schemes. If the offeror has no intentions to make any changes to the offeree company's pension schemes, or if it considers that its strategic plans for the offeree company will not have repercussions on the schemes, then the offeror should make a statement to this effect.

The Code Committee also proposes introducing a corresponding requirement on the board of the offeree company to include in the offeree board circular its views on the effects of implementation of the offer on the offeree company's pension schemes and on the likely repercussions of the offeror's strategic plans for the offeree company on the schemes.

Importantly, an offeror or the board of the offeree company would be committed to any statements it makes in relation to any action which it intends to take (or not take) with regard to the offeree company's pension schemes for a period of 12 months from the date on which the offer period ends (or for such other period as is specified in the statement) unless there has been a material change of circumstances.

3.2 *Provision of information to pension trustees*

In order to assist the pension trustees in formulating their views on the effects of the offer on the schemes, the Code Committee proposes that an offeror and the offeree company should be required to make available to the trustees all the documents that they are each required to make available to the offeree company's employee representatives, including:

- the announcement which commences the offer period;
- the announcement of a firm intention to make an offer;
- the offer document and any revised offer document; and
- the offeree board circular in response to the offer document and any revised offer document.

3.3 *Right for the pension trustees to publish their opinion of the offer*

The Code Committee proposes granting the pension trustees equivalent rights to those provided to the offeree company's employee representatives to have appended to an offeree board circular a separate opinion from the pension trustees on the effects of the offer (and any revised offer) on the pension schemes. The Code Committee also proposes that (as is the case for employee representatives) the offeree company should be required to inform the pension trustees of their right to publish their opinion at the time that a copy of an announcement which commences an offer period or an announcement of a firm intention to make an offer is made available to them.

Under the Code Committee's proposals, the offeree company will be required to pay for the costs of publishing the opinion, but will not be required to cover any costs incurred by the pension trustees in obtaining advice required for the verification of the information contained in such an opinion.

3.4 *Agreements entered into between an offeror and the pension trustees*

In order that any agreement between the offeror and the pension trustees relating to the future funding arrangements for the scheme can be reviewed by the beneficiaries of the pension scheme and other interested parties, the Code Committee proposes introducing amendments to the Code to require that where an agreement is entered into (a) a summary of that agreement must be included in the offer document, and (b) unless the Panel agrees otherwise, a copy of the agreement must be published on a website.

4. Consultation on companies subject to the Code

Section 3 of the Introduction to the Code sets out the rules as to the companies, transactions and persons to which the Code applies. Currently, an offer for a public company which has its registered office in the United Kingdom, the Channel Islands or the Isle of Man and whose securities are not admitted to trading on a regulated market in the United Kingdom[3] or on any stock exchange in the Channel Islands or the Isle of Man will be subject to the Code only if the company is considered by the Panel to have its place of central management and control in the United Kingdom, the Channel Islands or the Isle of Man. This is commonly referred to as the "residency test".

When applying the residency test, the Panel will look at the structure of the board, the functions of the directors and where they are resident. If a majority of the directors of the company in question are resident in the United Kingdom, the Channel Islands, or the Isle of Man, then the residency test will normally be satisfied. Where there is an even split between the number of directors who are resident in the United Kingdom, the Channel Islands, or the Isle of Man, and those who are not, the Panel will typically consider where the company's chairman is resident and whether he has the casting vote in relation to board

[3] The Main Market of the London Stock Exchange is a regulated market, but AIM is not.

decisions. If he does, and he is resident in the United Kingdom, the Channel Islands or the Isle of Man, the residency test will normally be satisfied. On occasion, the Panel may have to take into account other factors, such as the functions of the directors and the history of the company.

The Code Committee proposes amending the Code to remove the residency test. It advances a number of arguments to support this proposal. In summary:

- it is undesirable for an offer for a company which has its registered office in the United Kingdom, the Channel Islands or the Isle of Man, and in whose securities the public may have invested (but which are not admitted to trading on a regulated market), not to be subject to the Code. Shareholders in such companies will often have an reasonable expectation of Code protection, which will be frustrated if the company does not satisfy the residency test;

- reliance on the residency test can create uncertainty, since it is often impossible for an outside party to determine whether the residency test is satisfied and therefore whether the Code will apply to an offer for a given company. The jurisdiction of the Code should be capable of being easily verified by reference to public information, without the need either to consult the company in question or for the Panel to make a subjective judgement based on considerations such as the residency of the company's directors; and

- the application of the residency test means that the status of an offeree company under the Code can be susceptible to change should its directors relocate. This can present a number of practical difficulties should an offer or other transaction to which the Code relates be either in existence or in contemplation at the time that the change occurs.

The Code Committee acknowledges that removing the residency test will extend the territorial scope of the Code, which may mean that where an offeree company does not have a sufficient nexus with the United Kingdom, the Channel Islands or the Isle of Man, its activities may be harder to monitor, the Panel may not be able to undertake its regulatory responsibilities effectively and the threat of Panel sanctions may not act as a sufficient deterrent to non-compliance with the Code. However, the Code Committee considers that these potential downsides can be mitigated and on balance it is preferable to remove the residency test for the reasons mentioned above.

The Code Committee also proposes some minor clarifying amendments to the "ten year rule" in the Introduction to the Code to make clear that the Code will apply to an offer for a private company which has its registered office in the United Kingdom, the Channel Islands or the Isle of Man and whose securities have been admitted to trading on a regulated market or any multilateral trading facility in the United Kingdom or any stock exchange in the Channel Islands or the Isle of Man at any time during the 10 years prior to the relevant date. The Code

Committee does not believe the proposed amendments to the ten year rule will alter the application or effect of the Code in any material way.

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If you have any questions, please feel free to contact any of your regular contacts at the firm or any of our partners and counsel listed under Mergers, Acquisitions and Joint Ventures in the "Practices" section of our website at http://www.clearygottlieb.com.

CLEARY GOTTLIEB STEEN & HAMILTON LLP

CLEARY GOTTLIEB

Office Locations

NEW YORK
One Liberty Plaza
New York, NY 10006-1470
T: +1 212 225 2000
F: +1 212 225 3999

WASHINGTON
2000 Pennsylvania Avenue, NW
Washington, DC 20006-1801
T: +1 202 974 1500
F: +1 202 974 1999

PARIS
12, rue de Tilsitt
75008 Paris, France
T: +33 1 40 74 68 00
F: +33 1 40 74 68 88

BRUSSELS
Rue de la Loi 57
1040 Brussels, Belgium
T: +32 2 287 2000
F: +32 2 231 1661

LONDON
City Place House
55 Basinghall Street
London EC2V 5EH, England
T: +44 20 7614 2200
F: +44 20 7600 1698

MOSCOW
Cleary Gottlieb Steen & Hamilton LLC
Paveletskaya Square 2/3
Moscow, Russia 115054
T: +7 495 660 8500
F: +7 495 660 8505

FRANKFURT
Main Tower
Neue Mainzer Strasse 52
60311 Frankfurt am Main, Germany
T: +49 69 97103 0
F: +49 69 97103 199

COLOGNE
Theodor-Heuss-Ring 9
50688 Cologne, Germany
T: +49 221 80040 0
F: +49 221 80040 199

ROME
Piazza di Spagna 15
00187 Rome, Italy
T: +39 06 69 52 21
F: +39 06 69 20 06 65

MILAN
Via San Paolo 7
20121 Milan, Italy
T: +39 02 72 60 81
F: +39 02 86 98 44 40

HONG KONG
Bank of China Tower
One Garden Road
Hong Kong
T: +852 2521 4122
F: +852 2845 9026

BEIJING
Twin Towers – West (23rd Floor)
12 B Jianguomen Wai Da Jie
Chaoyang District
Beijing 100022, China
T: +86 10 5920 1000
F: +86 10 5879 3902

BUENOS AIRES
CGSH International Legal
Services, LLP-
Sucursal Argentina
Avda. Quintana 529, 4to piso
1129 Ciudad Autonoma de Buenos Aires
Argentina
T: +54 11 5556 8900
F: +54 11 5556 8999

SÃO PAULO
Cleary Gottlieb Steen & Hamilton
Consultores em Direito Estrangeiro
Rua Funchal, 418, 13 Andar
São Paulo, SP Brazil 04551-060
T: +55 11 2196 7200
F: +55 11 2196 7299