CLEARY GOTTLIEB Alert Memo

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UK Takeover Panel Sets Out Proposals to Ban Break Fees, Introduce Other Material Changes

Executive summary

On 21 March 2011, the UK Takeover Panel (the "**Panel**") set out detailed proposals to amend the regulation of UK takeovers. The proposals included the following:

- The banning of break fees, implementation agreements, exclusivity undertakings and other bid related undertakings given by a target company to a bidder or potential bidder. However, a *de minimis* break fee (not exceeding 1% of the value of the target) payable to: (i) a "white knight" in circumstances where target is already subject to a hostile bid; or (ii) the successful bidder in an auction process initiated by the target, will each normally be permissible with the consent of the Panel.

- A requirement for all potential bidders who have approached the target (and have not been rebuffed) to be named in any initial announcement[1] made by the target in respect of a possible bid. In practice, this may result in potential bidders being publicly "outed" by the target at the start of a possible transaction with the consequences contemplated by the immediately following paragraph.

- Any potential bidder, once publicly identified, will normally have a fixed 4 week period in which to either formally bid, state its intention not to bid (in which case it will normally be bound by such statement for a period of 6 months), or, jointly with the target, request an extension to the 4 week period.

- A requirement for bid documentation, in all cases, to set out details of the financing of the offer (including in relation to debt facilities, amounts, security, repayment terms, interest rates and key covenants) as well as details of fees and expenses (including up-front, commitment and draw-down fees) payable in connection with financing arrangements.

The proposals are expected to be formally implemented in the second half of 2011.

Consultation Paper

[1] Save for an announcement in respect of a formal auction process

The Code Committee (the "**Committee**") issued a consultation paper on 21 March 2011 setting out its detailed proposals for amendments to the UK Takeover Code (the "**Code**"). Implementation of these proposals (some of which have been strongly resisted by the private equity industry amongst others) will result in material changes to the conduct of takeover transactions subject to the Code.

Key amendments contemplated by the consultation paper are as follows:

1. Possible offer announcements and "put up or shut up"

Statements of a possible bid do not normally oblige a potential bidder to proceed to make a formal bid.

The Panel will normally require a brief statement of a possible bid where there is rumour and speculation and/or a material movement in the target's share price. This obligation will normally fall on the potential bidder where no approach has been made to the target, or the target where an approach has been made. Some bidders in UK takeover transactions have in recent times also sought to make such brief statements voluntarily for the purposes of putting pressure on a target company to open its books and/or to gauge likely market reaction to a possible bid.

Under the current regime: (i) there is in general terms no specific obligation on a target to publicly name a potential bidder (whether a bidder is named would depend on the circumstances); and (ii) at the request of the target company, the Panel can, following a possible bid announcement which identifies a potential bidder, impose a "put up or shut up" order requiring a potential bidder to, within a period set by the Panel, either formally bid or state that it does not intend to bid (in which case such statement will normally be binding for a 6 month period).

Proposed amendments

- Any possible bid announcement made by a target company at the outset of a potential Code transaction must now identify any potential bidder with whom the target company is in talks or from whom the target company has received an approach (which has not been unequivocally rejected).[2] It will not be

[2] Once the bid period has started (by a possible bid announcement), there is no requirement for the target company to publicly identify any other potential bider(s) except in circumstances where: (i) the potential bidder is subsequently identified (accurately and specifically) in rumour and speculation; and (ii) a subsequent announcement (to the announcement which commences the bid period) made by the target refers to the existence of a new potential bidder.

possible for a bidder to seek to contractually prevent a target from complying with these obligations. It is not entirely clear whether a potential bidder who has made a very preliminary approach to, or is in very preliminary talks with, the target would need to be identified but this seems to be the intention of the proposed amendments. The proposed amendments also appear to require all potential bidders to be identified whether or not any particular bidder was the subject of any rumour or speculation or other conduct which gave rise to a requirement for an announcement.

- Any publicly named bidder must normally, within a fixed period of 4 weeks following the date on which the bidder is named: (i) announce a formal bid; (ii) state that it does not intend to bid (in which case the 6 month period referred to above would apply); or (iii) make an application jointly with the target for an extension of the deadline. A target will not be able to agree in advance to seek an extension.

- A potential bidder participating in a formal sale process initiated by the target company will not however normally be required to be publicly identified and would not be subject to the 4 week deadline in each case for so long as it participates in that process.

Comments

There has been concern raised that the new regime could incentivize target companies to: (i) leak details of potential bids (which would in turn require an announcement identifying potential bidders); and/or (ii) unilaterally "out" potential bidders at the outset of a possible bid process. In each case, the effect would be the application to each potential bidder of a 4 week "put up or shut up" period.

The automatic application of a 4 week "put up or shut up" period has particularly concerned the private equity industry, which has argued that a four week period is not sufficient to allow private equity bidders to complete diligence and arrange necessary financing.

2. Deal protection measures

These measures, which have become increasingly prevalent in UK takeover transactions in the past 10 years, include break fees, exclusivity agreements, undertakings to implement a bid and matching and topping rights.

Proposed amendments

- A general prohibition on inducement or break fees, arrangements having a similar or comparable financial or economic effect and any other bid-related agreements, arrangements or commitments (including implementation agreements) proposed to be entered into between a target company and a bidder (and any person acting in concert with either of them).

- The general prohibition will not be applicable to amongst other things: (i) commitments to maintain confidentiality; (ii) commitments not to solicit employees, customers or suppliers; (iii) irrevocable undertakings to accept a bid; (iv) commitments to provide information that is required in order to satisfy the bid conditions or obtain regulatory approvals; and (v) agreements and arrangements which impose an obligation on a bidder or a person acting in concert with a bidder (eg a reverse break fee).

- The general prohibition above will also not normally restrict the payment by a target company of a *de minimis* break fee (not exceeding 1% of the value of the target under the bid) to: (i) a successful bidder in a formal auction process initiated by the target company; or (ii) a "white knight" in circumstances where another potential bidder has already formally announced a hostile bid for the target company.

- The Committee also states that the Panel may be prepared to grant a dispensation from the above rules (for a break fee) in circumstances where a potential bidder would only be prepared to make a bid for a target company in serious financial distress if that potential bidder were permitted to enter into a work-fee arrangement or other form of bid related arrangement or break fee.

Comments

UK takeover transactions did not extensively feature deal protection measures prior to 2000 and so it remains to be seen whether the impact of the general prohibition will have a significant effect on the UK takeover market as a whole (and particularly on non-private equity bidders).

The general prohibition has however particularly concerned the private equity industry, which has argued that private equity bidders will be dissuaded

from bidding in circumstances where they will be unable to recover work related and financing costs through a break fee payable on a deal busting event.

3. Disclosure of bid related fees

Under the current regime, bid related fees would not normally be separately disclosed (except in more unusual circumstances to the extent they were material in the context of the bid).

Proposed amendments

- Each of the parties to a bid must set out an estimate of aggregate bid fees in the bid related documentation.

- The estimated fees of the advisers to each of the parties to a bid (including financial advisers and corporate brokers, accountants, lawyers and public relations advisers) should be disclosed separately, by category of adviser.

- Fees in respect of financing arrangements (including up-front fees, fees payable on draw-down and any other "commitment" fees) should be disclosed separately from advisory fees. Disclosure of fees in respect of financing arrangements should be made on the basis that the bid will complete and that the bid finance will be drawn down in full.

- Maximum and minimum amounts payable as a result of success, incentive or ratchet mechanisms should also normally be disclosed.

4. Disclosure of financial information about a bidder and its financing regardless of the nature of the bid

Under the current regime, less financial information in respect of a bidder, and its financing, is required in circumstances where the bidder is making a cash bid and there are not likely to be minority shareholders in the target following completion of the bid.

Proposed amendments

- The same detailed information with respect to the financial position of the bidder and the financing of the bid should be disclosed in all bids (that is, irrespective of whether the bid is all cash, a securities exchange bid or whether shareholders in the target company might become minority shareholders in the target company controlled by the bidder). By way of exception to the general rule, a cash bidder will not have to include a statement regarding the absence of material adverse change since the date to which its last audited accounts were made up.

- In particular, the bid related documentation is in all cases to include details of any debt facilities entered into to finance the bid, the amount of each facility, the repayment terms, interests rates (including any step up or other variation provided for), any security provided and a summary of the key covenants.

- The Committee has specifically noted that it understands that private equity bidders may have complex financing structures with various layers of debt, plus equity from a fund or funds of the private equity sponsor. The Committee has stated that it understands that the structures by which equity is provided to private equity bidding vehicles may be commercially sensitive and does not consider that such equity structures should be required to be disclosed in detail.

- All documents relating to the financing of a bid should be put on display without redaction.

5. Amendments which improve the quality of disclosure about a bidder's intentions for the target company and its employees, and to improve the ability for employee representatives to give their views.

Proposed amendments

- Bidders will be required to make negative statements if they have no plans regarding the target's employees, locations of business and fixed assets.

- Statements made by bidders (and were applicable, targets), whether in offer related documents, announcements or otherwise, regarding intentions with respect to the target company and in particular the target company's employees, locations of business and fixed assets, must normally be adhered to for a period of at least 12 months from the date on which the bid becomes wholly unconditional. If, within the relevant period, a person acts contrary to such stated intentions, and the Panel is not satisfied that it was reasonable to make the statement, the Panel reserves its rights to take disciplinary action against that person.

- Other proposed amendments the purpose of which is to improve the ability of employees and their representatives to provide opinions on a bid. These include a requirement for the target to pay for the publication of any employee representatives' opinion and a requirement for the target to pay the costs incurred by employee representatives in obtaining advice to verify the information in the opinion to Code standards. The existing rules provide that the target will be required to append the opinion of employee representatives' to the target bid documentation if that opinion is received in good time before

issue of the bid documentation. The proposed amendments include an obligation on the target to publish the opinion on its website if the opinion is not received in time for it to be included in the bid documentation.

When are the proposed amendments likely to take effect?

The proposals set out in the 21 March 2011 consultation paper do not yet form part of the Code. Given that this is the second statement of the Code's position on these matters, we would expect the amendments contemplated by the 21 March 2011 consultation paper to be implemented into the Code without significant amendment.

In terms of timing, comments on the detailed amendments are due on 27 May 2011. Following receipt of such comments, the Committee will issue a response statement setting out the final amendments to the Code. The Committee has specifically indicated that, following the publication of its response statement, it does not currently envisage that there will need to be a lengthy transitional or implementation period. We would therefore expect the amendments to be incorporated into the Code in the second half of 2011 (and most likely at or around the start of the last quarter of 2011).

If you have any questions in relation to this memo, please contact Simon Jay (44 207 614 2316) or Sam Bagot (44 207 614 2232).

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