Coping with change: a view from the UK Takeover Panel

By Barbara Muston

The late 1950s appear to have been a lively time in the City of London. The profile of share ownership of companies was changing in the post-war environment, the hostile bid had arrived on the scene and while hostile offerors were doing whatever they could to make their bids succeed, the boards of offeree companies were in turn taking such action as they thought fit to defend their companies – and, in some cases, their own positions. Minority shareholders were often left to fend for themselves.

It seems that most of what were then referred to as "amalgamations" were uncontested but those that were not were apparently "attended by undue publicity".[1] Clearly, the formerly gentlemanly atmosphere of the City was being ruffled and with some politicians calling for a statutory body to regulate takeovers and mergers, the Governor of the Bank of England stepped in to convene a City Working Party comprising major City organisations[2] in order to draw up a "general guide to the principles and practices to be followed in such operations". This general guide, entitled "Notes on Amalgamations of British Businesses" was published in October 1959. Recognising that "circumstances can differ so greatly that no completely comprehensive code applicable to all cases is possible", under the headings of "Principles" and "Procedure" the Notes laid out the bare bones of a code of conduct which the Committee felt would be "of use in the majority of cases".

The principles included the thoughts that there should be no interference with free markets, that it was for shareholders to decide whether or not to sell their shares, that they should be provided with adequate and timely information in order to enable them to make the decision and that every effort should be made to avoid disturbance in the normal price level of shares before that information was made

1 Notes on Amalgamation of Businesses, 1959.

2 The Issuing Houses Committee, The Accepting Houses Committee, The Association of Investment Trusts, The British Insurance Association, The Committee of London Clearing Bankers and The Stock Exchange.

available. The Procedures gave further details of the relevant information to be provided, including the resources available to the offeror to back the offer and a statement of the offeror's general intentions as to the future conduct of the company and its effect on employees. They also advised that as a general rule, an offer should be made for the whole of the share capital of a company, dealt with the problems of secrecy before announcement of an offer and the timing of such announcements, indicated a minimum of three weeks for the acceptance period and warned Boards that they should be wary of refusing to put to their shareholders any serious and responsible offer.

These precepts, well known to us now, were, it seems, largely ignored. In 1962, a report was published by the Jenkins Committee on Company Law, which included a recommendation that the Government should have power to make rules to apply to every takeover offer. With the prospect of statutory regulation looming larger, in 1963, the City Working Party was reconvened. It revised and extended the Notes, introducing for the first time the idea that they were concerned as much with the spirit in which transactions should be conducted, as with strict procedures, bearing in mind that practices could develop and change with great rapidity. The changes, however, appear to have made little impact. As London was swinging its way through the 1960s, it seems that parties to bids, aided in some cases by their advisers in the City, were doing just as they pleased and flouting the Notes with impunity.

During the first half of 1967, there was a huge amount of takeover activity and some bids were bitterly contested. Practices such as the offeree board making over-optimistic forecasts, the offeror doing special deals with selected shareholders and non-disclosure by the offeror of holdings in the offeree appear to have been common. There was more public criticism and the Governor of the Bank of England, with the Chairman of The Stock Exchange, reconvened the City Working Party once again. This time, realising that something had to be done to ensure that the rules were enforced, it was announced in September 1967 that a Panel would be established to supervise the operation of the revised Code. Membership of the Panel was to be widely representative of "informed City opinion" and would thus be drawn from the bodies making up the City Working Party and, in addition, the Confederation of British Industry and the National Association of Pension Funds. All of these bodies, and other interested parties, were invited to put forward their ideas for how the rules should be revised and over the following 6 months the Working Party toiled over the drafting of the new Code. Finally, on 27 March 1968, the City Code on Takeovers and Mergers and the Panel saw the light of day.

It would be good to be able to say that it was all plain sailing after that but in fact, that was far from being the case. Within months of the Code's being published, there were a number of major disputes about the meaning of rules and the Panel's authority was tested severely; some even suggested that the Panel should be written off as an experiment that had failed.[3] It was only after months of further discussion that all parties concerned could agree, in April 1969, not only to the revised rules but also, importantly, to a reconstituted Panel with powers to impose sanctions for breaches of the Code, which thus could command the respect of the regulated community.

Looking back, it is clear to see that this agreement was hard won and ultimately, it must be credited to the determination of a few individuals, together with a collective belief among all the City bodies that it would be better to be governed by a voluntary Code rather than regulated by statute.

A key to the effective working of the Panel and the acceptance by the City of its power to impose sanctions for breaches of the Code, was that its secretariat, the Panel Executive, was to make itself available for consultation and to give rulings on points of interpretation of the Code. In the event of any disagreement, there was to be a right of appeal to the Panel, whose decision was final. If the Panel found that there was a breach of the Code, the sanctions available to it were to be private or public censure or, in serious cases, further action designed to deprive the offender temporarily or permanently of his ability to practise in the field of takeovers and mergers. But no breach of the Code could be determined and no disciplinary action could be taken without giving the person concerned the right of appeal to a separate Appeal Committee.

Nearly 45 years on, the system which was hammered out in 1968–69 remains essentially intact and the Panel of today owes a debt of gratitude to those wise men (and, of course, they were all men in those days) who took such care in crafting it. They could not possibly have envisaged the changes in practice that have transformed the UK securities markets and corporate finance techniques in the intervening period but they created a body capable of responding to change and of applying the rules pragmatically in a changing world. Critical to this

3 Letter from the Governor of the Bank of England to the Chairman of the Issuing Houses Association, in Panel Statement 1968/7 (www.thetakeoverpanel.org.uk).

was the fact that they persuaded all the bodies representing practitioners in the City to buy into the system, amending their own rules to require their members to comply with the Code. However, just as important was their recognition that it was not possible to create a set of detailed rules to cater for all the eventualities that might arise in the context of a takeover bid and that the Panel had to be able to apply such rules as were set down with speed and flexibility, interpreting them and the General Principles in accordance with their spirit in order to achieve their underlying purpose in any particular set of circumstances.

The Panel has now regulated over 8,000 bids, as well as thousands of other cases in which shareholders approved a change in corporate control resulting from the issue of voting securities to a new controller, or possible offers which were, in the event, abandoned. It was made clear right from the very beginning that it was not for the Panel to comment on the commercial merits of any bid nor was it concerned with issues, such as competition policy, which are rightly the responsibility of government. Its clear purpose has always been to provide and enforce an orderly framework for the conduct of takeovers and to protect shareholders' interests, essentially by ensuring that all shareholders are treated fairly and equally.

This task has presented the Panel with many challenges over the years and it has had to adapt itself and the Code to meet them. In its first edition, the Code was contained within a small pamphlet of only 13 pages, which comprised 6 General Principles and 35 Rules; now, however, the well-known "Blue Book" runs to more than 265 pages, including an Introduction, which sets out the Panel's constitution and functions, including, now, its statutory functions, 6 (slightly different) General Principles, Definitions, 38 Rules and their associated Notes and 7 Appendices.

It is sometimes suggested that the increasing involvement of lawyers in takeovers over the last decade or so has been responsible for more detail being written into the Code but it is much more the case that throughout the Panel's history, new situations have arisen during bids, new practices have developed or external events have occurred that have had to be accommodated. As far as possible, the Panel aims to be proactive and prepare for change before it arrives and the Code is kept constantly under review by the Code Committee and the Executive. There is a tension between trying to ensure that the Code is kept up to date and in tune with developments and preventing it from becoming over-burdensome to its constituents while aiming to keep change a minimum.

Structural and legislative changes that may have an impact on the Panel are generally easy to spot as they loom over the horizon. "Big Bang" in 1986 was one such change which transformed operations in the City and led to the creation of multi-service financial organisations. This in turn led to many new potential conflicts of interest within those organisations between their fund management, corporate finance and market-making or principal trading arms. The dangers were exacerbated by the fact that these new entities had access to vast new sources of capital.

To deal with these conflicts, the Panel created a new status within the Code for fund managers and another for principal traders who could satisfy the Panel's tests of independence; this, together with new disclosure rules, enabled them to continue their activities in the securities markets during takeovers with minimal constraint. This system, with some adaptation along the way, has stood up well over the last 25 years, weathering wholesale changes in market structure, including the move from a market-making system to an order book system in 1997 and the implementation of the Markets in Financial Instruments Directive in 2007.

Changes in practice are less easy to spot at first; they tend to creep up, making their presence felt gradually until there comes a point when it is clear that the Rules have to be amended, perhaps to block a loophole, to alter or control certain activities which could damage shareholders' interests or to cater for new bid structures.

An early example of this came in the first few years of the Panel's existence. The first edition of the Code did not, in fact, include the rule which encapsulates its raison d'être, the mandatory bid rule (Rule 9); that rule was introduced in 1972 because offerors and their concert parties had developed the practice of acquiring control of a company, through "creeping acquisition" in the market in a matter of days, before shareholders were aware of what was going on. The Panel acted promptly to bring in a rule to ensure that shareholders were provided with protection in these circumstances by being given an opportunity to exit the company when control (set at 30% of the voting rights since 1974) passed and also to share in any premium that the new controller had paid for control.

More recently, in the period 1995–2005, there was a significant increase in the activities of hedge funds and arbitrageurs during takeovers. They were, invariably, dealing in derivatives and it became increasingly clear to the Panel that it would have to amend the rules to address this change in practice. The issues were complex and a major consultation exercise was undertaken, concerning, initially, disclosure of dealings in derivatives and options and subsequently, the "control" issues: the Code consequences of such dealings by parties to an offer or their concert parties or persons having interests in the 30% to 50% band. The thread running through these changes was that long derivative interests and dealings in derivatives should be treated in the same way as such positions and dealings in shares. The Panel recognised that these innovative rule changes could have significant consequences for market participants but a review carried out a year after their introduction showed that they were working well and had not only been accepted but were supported by all the relevant constituencies.

It also became clear in recent years that increasing use was being made of statutory schemes of arrangement as a way of effecting mergers and acquisitions. These processes, involving approval of the courts, used to be thought of as being unwieldy and inflexible but bidders were finding ways of using them, even in competitive situations. Initially, this led the Executive to use its flexibility to adapt the application of the Rules but there came a point where these adaptations became standard practice and had to be codified.

There are some issues that have a tendency to come around again and again. One such is the whole question of secrecy before a bid and the prevention of false markets in that sensitive time before an announcement is made. The Panel was worried about this from its earliest days and introduced requirements which pre-dated the statutory offence of insider dealing by a decade. In the 1970s it was the Panel's practice to call suspected miscreants before it and in cases where their explanations for dealing were regarded as implausible to require the profits to be donated to charity.

However, in view of the difficulties of proving that insider dealing has taken place, the Panel's main efforts in relation to such activity have been focussed on ensuring that markets are kept appropriately informed by announcements. This has served investors well by ensuring that announcements are made in respect of potential transactions where there is rumour and speculation or untoward movements in share prices.

The Panel's requirements in this area have been under continual development almost throughout its life, most recently as part of a major review of the Code which led to amendments that came into force in September 2011.

There have, of course, been occasions on which an incident occurring during a bid has triggered a major change to the Code that had not been anticipated or perceived and where the Panel has had to act fast to remedy the situation. Perhaps one of the most significant examples arose from the bid by Guinness for Distillers in 1986. One of the issues in that case concerned the failure of certain parties to disclose dealings during the course of the bid. In response, even before the many legal matters arising from that case had been addressed, the Panel was able to act swiftly to amend the Code with a view to preventing these problems arising in the future. In particular, it introduced new and more detailed dealing disclosure requirements, to include the identity of the person dealing and to impose a public disclosure requirement on any person owning or controlling 1% or more or who would, as a result of dealing, come to own or hold 1% or more of the relevant securities of the company concerned. At the same time, the Panel began to monitor dealings in the market itself, rather than relying solely on obtaining information from The Stock Exchange. Market monitoring now plays a crucial role in the Panel's regulation of bids.

These days, while the Panel's Code Committee does have the power in exceptional cases to make amendments to the Code "on an expedited basis", for example because it appears to the Code Committee that a particular market development requires this, the normal process takes more time. Once a matter that might lead to Code amendment is identified, whatever its source, a public consultation paper is published to seek the views of interested parties, usually on specific proposals but sometimes with the aim of generating more open debate. The consultation is usually open for a period of two to three months, after which the Code Committee, taking the responses into account, publishes a Response Statement.

Coming up to date, the most recent changes to the Code, which entered into force only on 19 September, were the result of a major review of a number of aspects of the regulation of takeover bids, undertaken by the Code Committee during much of 2010 and 2011. This review was initiated in the light of widespread commentary and public discussion following the takeover of Cadbury plc by Kraft Foods Inc. in the first quarter of 2010. A general election was imminent and both the Government and the Opposition became interested. The Code Committee took the initiative by announcing that it would carry out a wide-ranging review of the Code, and it began by consulting publicly on all the many ideas that had been raised, some of which had been on the Panel's radar for some time, in order to open up the debate and identify the key issues without putting forward specific proposals.[4]

In the light of comments received, the Code Committee concluded that:

(a) "hostile" offerors (i.e. offerors whose offers are not from the outset recommended by the board of the offeree company) had, in recent times, been able to obtain a tactical advantage over the offeree company to the detriment of the offeree company and its shareholders, and that it intended to bring forward proposals to amend the Code with a view to reducing this tactical advantage and redressing the balance in favour of the offeree company; and
(b) changes should be made to the Code to improve the offer process and to take more account of the position of persons who are affected by takeovers in addition to offeree company shareholders.

The Code Committee then consulted on specific proposals for rule changes[5] and announced its conclusions in July 2011.[6]

Some of the key amendments address the regulation of "virtual bids", the tactic used by many bidders of announcing a possible offer and seeking, in the period before announcement of a firm offer, to gain access to the offeree company's books and, if possible, a recommendation from the offeree board. The Panel has had in place for some years a "put up or shut up" regime, the aim of which was to enable target companies to relieve themselves from the uncertainties of being "in play" within a relatively short period, by asking the Panel to impose a deadline on the potential offeror by which time it had to choose between announcing a firm offer or announcing that it had no intention of making an offer, in which case it would, generally, be unable to do so for a period of six months.

In practice, many offeree company boards did not make the request for a "put up or shut up" deadline, often for fear of being seen as being self-serving or defensive, particularly at an early stage in the offer period. As a result target companies were often exposed to long and drawn-out "virtual bid" periods, which adversely affected the conduct of their business and the board's negotiating position with the offeror, while the potential offeror was, in effect, able to bypass the board and

4 PCP 2010/2, available at www.thetakeoverpanel.org.uk.
5 PCP 2011/1.
6 RS 2011/1.

engage directly with offeree company shareholders to discuss the merits of a possible offer and the price at which such an offer might be made, without having to commit to making a formal offer.

Under the new rules, an automatic "put up or shut up" deadline of 28 days is imposed on a potential offeror as soon as an announcement commencing an offer period is made and the potential offeror must be named in that first announcement. However, the offeree company can choose to request an extension to the 28 day period if it wishes to continue in discussions with the potential offeror at the end of that period. The Code Committee believes that these Code changes will redress the balance in favour of the offeree company by: reducing the period of uncertainty and disruption before a firm offer announcement is made; removing the need for the offeree company board to make the difficult decision as to whether to identify a potential offeror and/or to ask the Panel to impose a "put up or shut up" deadline; and also by increasing the incentive for a potential offeror to avoid a leak of its potential interest in making an offer.

Other amendments have been made to prohibit deal protection agreements and inducement fees, which were designed to deter competing offerors and which had become almost a standard feature of bids, restricting the ability of offeree company boards to engage with potential competing offerors. This was judged to be detrimental to the interests of offeree company shareholders.

In addition, in order to increase transparency and the quality of disclosure, more information on the financial position of the offeror and on the financing of the offer now has to be disclosed as do offer-related fees. Furthermore, amendments have been made to improve the quality of disclosure by offerors and offeree companies in relation to the offeror's intentions regarding the offeree company and its employees and to improve the ability of employee representatives to make their views known.

The Code Committee encountered a certain amount of controversy in making these amendments and, given the significance of the changes, it has committed to undertaking a review of their operation in due course.

The Panel's ability to change and adapt and to apply the Code with flexibility has given it great strength and authority. It has been able to respond to the needs of its various constituents while still keeping in clear focus its main purpose of providing an orderly framework for the conduct of bids and the protection of offeree company shareholders. It has therefore continued to receive the support of industry, investors, professional practitioners and Government and so, despite many changes in the regulatory framework, it is still an independent body.

Perhaps the greatest testament to the Panel's success is the complete absence of tactical litigation in one of the world's most active markets for mergers and acquisitions. There have been attempts by parties to overturn decisions of the Panel by judicial review but the courts' approach to such cases was set by the Datafin case in 1986. In his judgement on that case, Lord Donaldson, then Master of the Rolls, described the Panel as a "*truly remarkable body. Perched on the 20th floor of the Stock Exchange in the City of London, both literally and metaphorically, it oversees and regulates a very important part of the United Kingdom financial markets. Yet it performs this function without visible means of support.*"

He went on to say that, "*In the light of the special nature of the Panel, its functions, the market in which it is operating, the timescales which are of interest in that market and the need to safeguard the position of third parties, who may be numbered in their thousands, all of whom are entitled to continue to trade upon an assumption of the validity of the Panel's rules and decisions, unless and until they are quashed by the court, I should expect the relationship between the Panel and the courts to be historic rather than contemporaneous. I should expect the courts to allow contemporary decisions to take their course, considering the complaint and intervening, if at all, later and in retrospect by declaratory orders which would enable the Panel not to repeat any error and would relieve individuals of the disciplinary consequences of any erroneous finding of breach of the rules.*" This judgement has been relied on in the handful of cases that have been taken to the courts since then and the courts have continued to show great reluctance to interfere in Panel decisions, which has also given the Panel a strong hand.

Nevertheless, there have been other potential challenges of a legal kind, not least of which was the European Takeovers Directive.[7] Although the Directive was, in many respects, modelled on the Code, including the General Principles (slightly modified) and, critically, the mandatory bid rule, the Panel had concerns during the many years of negotiation that when the Directive came to be implemented and regulation of takeovers in the UK was put on a statutory footing, the Panel would lose its flexibility and ability to respond to changing circumstances. It was also concerned that tactical litigation would resurface.

7 Directive 2004/25/EC on Takeover bids.

However, ultimately it was recognised in the Directive that, "*in order to be effective, takeover regulation should be flexible and capable of dealing with new circumstances as they arise and should, accordingly, provide for the possibility of exceptions and derogations*".[8] And when it came to implementing the Directive in the UK, the Government recognised and chose to preserve the strengths of the existing system, identifying these as: speed, flexibility and certainty in decision-making; principles-based regulation; the independence and autonomy of the Panel; the involvement of key stakeholders in developing the rules; the professional expertise of the Panel brought about by its membership and its practice of seconding staff from practitioners in the City; and the consensual approach to enforcement. As a result, in practice, the Directive has had very little impact on the regulation of takeovers in the UK. The Panel has been designated as the supervisory authority for the purposes of the Directive and it now has statutory duties and powers, including new enforcement powers (which it has not yet needed to use) but day to day, it has been very much business as usual.

The next challenge will be the review of the Directive, which is currently under way. Given the considerable difficulties in achieving agreement on the Directive and the continuing differences in underlying company law and shareholding structures in different Member States, the Panel believes that the current Directive provides the best possible framework for the regulation of takeover bids and considers that it would not be fruitful to attempt to create more detailed rules at the EU level. The Network of Takeover Regulators, convened originally under the auspices of CESR and now of ESMA,[9] already provides a means for facilitating greater common understanding between supervisors and harmonisation of practice, which can evolve with developments in the market. The Panel considers that the Network is likely to continue to provide the best means of ensuring closer co-operation in the future.

The Panel has achieved much to be proud of since 1968, not only domestically in the UK, but also in the influence it has had on regulators elsewhere, the authorities in Sweden being among the first to seek advice from the Panel when they were drafting their Code in 1971 and then again when the Swedish Takeover Panel was established in 1986. There will, undoubtedly, be many new challenges for the Panel ahead

[8] Recital 6, Directive 2004/25/EC on Takeover bids.

[9] CESR: the Committee of European Securities Regulators, which has been replaced by ESMA, the European Securities and Markets Association.

but, thanks to the determination and vision of its founders, it should remain well-equipped and able to cope with them in a pragmatic and timely way.

In one of its leaders some years ago, the Financial Times commented that “the Takeover Panel is regarded as one of the City’s most valuable institutions. For more than 30 years it has kept a level playing field in bids, ensuring investors are treated fairly, whilst changing its rule book pragmatically to keep up with changing markets. As a result, London’s framework is the envy of the world”.

Long may that sentiment continue.