November 27, 2023

Changes to UK Takeover Code

Restrictions on Frustrating Action and Access to Due Diligence Information

BACKGROUND

On October 27, 2023, the UK's Panel on Takeovers and Mergers (the "**Panel**") published the results of a consultation started in May 2023 to review the City Code on Takeovers and Mergers (the "**Code**"), together with proposed amendments to the Code. In general, the amendments will relax provisions of the Code that restrict the board of a target company from taking certain actions during the course of a takeover on the basis that they constitute "frustrating action". They will also streamline the process by which competing bidders can access equivalent due diligence information from the target.

In summary, the amendments will:

- permit alterations to the target's share capital, acquisitions or disposals of assets, and entry into, amendment or termination of contacts without target shareholder approval if the action is carried out in the ordinary course of the target's business;
- extend the period during which the restrictions on frustrating action apply following the rejection of an approach from two business days to seven business days;
- enable potential competing bidders to exercise their right under the Code to request due diligence information in general terms, replacing the current practice of submitting specific information requests; and
- clarify the application of certain aspects of the Code restrictions on frustrating action to schemes of arrangement in competitive situations.

The amendments to the Code will take effect from December 11, 2023. Any ongoing transactions will be subject to the amended provisions, except where to do so would give the amendments retroactive effect.

The Panel has also published a new Practice Statement No 34 ("**PS34**") which provides guidance on how the Panel will administer the relevant aspects of the revised Code in practice.

OVERVIEW OF CURRENT RESTRICTIONS ON FRUSTRATING ACTION

Rule 21.1 of the Code restricts the board of a target company from taking any action which may result in an offer or bona fide potential offer being frustrated or in shareholders being denied the opportunity to consider an offer on its merits, without the approval of the target's shareholders. The restriction is broad and phrased in general terms, and the Code requires target boards to consult the Panel before taking any action that could infringe it.

In addition, Rule 21.1 lists a number of actions that are explicitly restricted. Currently, these broadly comprise:

- alterations to the target's share capital, such as by issuing shares or granting options;
- acquisitions or disposals of assets of a material amount; and
- entry into contracts otherwise in the ordinary course of business.

Rule 21.1 limits the defensive actions that target boards can take. It is the reason why tactics such as shareholder rights plans (or "poison pills"), deployable in other jurisdictions, do not feature in UK takeovers.

The period during which Rule 21.1 applies (the "**relevant period**") currently starts on the date the target board has reason to believe that a bona fide offer might be imminent (or, if earlier, when a firm offer or possible offer announcement is made) and terminates at the end of the offer period. The Panel will normally consider the board to have reason to believe a bona fide offer might be imminent following an approach by the bidder. If the board unequivocally rejects the approach (and no offer is announced), the relevant period currently ends at 5.00 pm on the second business day following the date of the rejection.

THE KEY CHANGES

The key changes are summarised below.

A. INCREASED FREEDOM FOR TARGET BOARDS TO CARRY OUT ORDINARY COURSE OR IMMATERIAL ACTIONS

In its consultation paper, the Panel explained that it considers Rule 21.1 can prevent targets from carrying out their normal activities, and that it has become disproportionately burdensome as offer timetables have become increasingly protracted in recent years (owing primarily to extended and more detailed regulatory reviews).

Accordingly, the Code is being revised such that:

- alterations to share capital will not be restricted if they are in the ordinary course of the target's business; and
- acquisitions or disposals of assets and the entry into, termination or amendment of contracts will not be restricted if they are either in the ordinary course of the target's business or are immaterial.

As an ordinary course exception currently applies only to contracts, and a materiality exception currently applies only to acquisitions or disposals of assets, this represents a significant relaxation of the regime. Target boards will, though, still need to consult the Panel before carrying out any action which may be restricted. The Panel will then determine whether a proposed action is in the ordinary course of business or is immaterial.

Under the revised Code, in a reverse takeover scenario the restrictions on frustrating action will now also apply to the bidder as if it were a target and vice versa. Details of other changes being made in this area are set out below.

Alterations to share capital

Grants of options and awards where the timing and level are in accordance with the target's normal practice under established incentive schemes are not currently restricted. Under the revised Code, the Panel will normally also consider grants of options or awards consistent with the target's proposed practice under a new incentive scheme (or that otherwise diverge from past practice) to be ordinary course, provided the scheme (or divergence from past practice) was publicly disclosed before the beginning of the "relevant period".

Redemptions or share buybacks made in line with defined limits announced or established before the "relevant period" will also normally be considered to be in the ordinary course.

However, the Panel may now treat putting in place offer-related retention arrangements that will relate to a period that is (in whole or in part) prior to the end of the offer period, whether in cash or in the form of options or awards, as a restricted action if the arrangements are significant in value or relate to directors or management. PS34 provides that the Panel will not normally regard such arrangements as being significant in value where the aggregate value of the arrangements is no more than 1% of the value of the target, calculated by reference to the price of the takeover offer. The revised Code will require target boards to consult with the Panel before putting any such arrangements in place.

The restrictions that currently apply to incentivisation arrangements proposed to be put in place by the bidder (rather than the target) will continue to apply in parallel. Under Rule 16.2 of the Code, such arrangements may similarly need to be approved by target shareholders if they are significant and/or unusual.

Acquisitions or disposals of assets of a material amount

The consideration, assets and profits tests (used to assess the materiality of acquisitions or disposals relative to the size of the target) will be retained. Smaller transactions that are not individually material will continue to be aggregated when applying the tests. However, as the revised Code will only restrict non-ordinary course acquisitions or disposals, ordinary course transactions will usually no longer need to be included in the aggregation. The Panel may now also have regard to alternative indicators of materiality it considers appropriate, including where one or more tests produce an anomalous result.

PS34 also sets out matters the Panel will consider when determining whether a proposed acquisition or disposal is in the ordinary course, including whether:

- it falls within the established business model of the target;
- its terms and the basis of valuation are in line with normal practice by reference to either a broader market or previous transactions entered into by the target or its peers; and
- it is part of an ongoing strategy, rather than a strategic change.

Entering into, amending or terminating material contracts

The revised Code does not set out a specific test for assessing whether a contract is material. PS34 states that the Panel's assessment will primarily look to the size of the contract compared to other contracts entered into by the target while noting that this is a low threshold.

PS34 also sets out certain factors the Panel will consider when determining whether a contract is in the ordinary course, including:

- the frequency with which the target has entered into similar contracts;
- the size of the contract in comparison to similar contracts entered into by the target;
- whether the contract is of particular importance to the target's business;
- the terms of the contract and whether any non-market terms are onerous on the target; and
- if relevant, the costs associated with terminating or amending the contract.

Specific guidance is provided in relation to certain types of contract. Regular or maintenance capital expenditure, refinancing or new debt financing on market terms, property lease management and settlement agreements in relation to commercial disputes or compromise agreements with departing directors or employees will all normally be considered ordinary course for these purposes.

B. "RELEVANT PERIOD" DURING WHICH RESTRICTIONS LAST INCREASED FROM TWO TO SEVEN BUSINESS DAYS FOLLOWING A REJECTED APPROACH

Under the revised Code, the relevant period will continue to start at the time of an approach by the bidder to the target board (or, if earlier, when a firm offer or possible offer announcement is made) and terminate at the end of the offer period. However, where the target board unequivocally rejects the approach (and no offer is announced), the relevant period will now end at 5.00 pm on the seventh business day following the date of the rejection.

C. COMPETING BIDDER DUE DILIGENCE REQUESTS TO REMAIN LIVE FOR SEVEN DAYS AND CAN BE MADE IN GENERAL TERMS

To level the playing field between competing bidders, Rule 21.3 of the Code requires the target board to supply to any bona fide potential competing bidder on request any information it has shared with another bidder. This obligation will normally only apply when the bidder with whom information has been shared has been publicly identified (or when the potential competing bidder has been informed authoritatively of the existence of another bidder). It applies even where the potential competing bidder is less welcome than the other bidder.

The current Code prevents bidders from asking for all information shared with other bidders in general terms. To facilitate near real-time access to information, it is market practice for bidders to submit regular, detailed information requests. The Panel considers that this practice creates an unnecessary administrative burden.

Accordingly, the Code is being revised such that the target will be required to supply to any potential competing bidder: (i) on request, any information that has been supplied to any other bidder at the time of the request (whether or not that information is specifically requested by the potential competing bidder); and (ii) any further information supplied to any other bidder within the next seven days. Market practice may therefore evolve such that bidders submit one general request every seven days.

Similarly, the independent directors of a target that is subject to a management buyout will now be able to request from the bidder in general terms any information that it has shared with the bidder's external providers of equity or debt finance. In this case, the request will remain "evergreen" – with the bidder required to supply to the independent directors any further information provided to its financiers throughout the rest of the offer.

D. CHANGES AFFECTING SCHEMES OF ARRANGEMENT IN COMPETITIVE SITUATIONS

The Panel has reviewed how the restrictions on frustrating action should apply where one or more competing bidders have structured their offer as a court-sanctioned scheme of arrangement (rather than a contractual offer). In such cases, the sanction of one bidder's scheme of arrangement would preclude the competing bid. The Panel has decided that, other than in exceptional circumstances, it will nevertheless not apply Rule 21.1 to a decision by the target board to seek to sanction a scheme relating to a competing bid.

The Panel has also revised the rules regarding "mini-long-stop dates". These are included in schemes of arrangement to provide deadlines by which the required shareholder meeting and court sanction meeting must be held. Currently, the target board's consent is required to extend these deadlines. In a competitive situation, the target board therefore has the power to force on a less favoured bidder a binary decision either to lapse its offer on the mini-long-stop date or waive the mini-long-stop date completely. To address this, the revised Code will permit competing bidders to extend these deadlines without the target board's consent, provided the Panel agrees.

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