



## *WING TIPS*

### *Takeovers – How the rules are relevant to SMEs*

To many, mention of a "takeover" conjures up images of multi billion pound bids for household names such as the competing approaches made for the London Stock Exchange plc. However, the City Code on Takeovers and Mergers (the City Code) and the wider takeover legal regime have a much broader scope than just FTSE companies. Whilst recent changes to the status of the Panel on Takeovers & Mergers and to the City Code have increased the powers and reach of the Panel for (typically) larger companies, smaller companies and their shareholders also need to be aware of the various rules which can be used either to force through an acquisition of the company against the will of minority shareholders or to frustrate the ambitions of an unwelcome suitor.

#### **Does the City Code apply?**

The City Code was revised in May 2006 following the implementation of the European Takeover Directive in the UK. We are currently in an unsatisfactory period of transition where some of the City Code's rules apply differently depending upon the nature of the target. In particular, the City Code has statutory force only in relation to certain companies listed on the Official List of the London Stock Exchange and not to the other companies to which it applies and this will continue until the Companies Bill comes into force in 2007.

As you would expect, the City Code broadly applies to public companies which have their registered offices in the UK, the Channel Islands or the Isle of Man where any of their securities are traded on the Official List of the London Stock Exchange or are admitted to trading on exchange regulated markets like AIM if they are considered by the Panel to have their central place of management and control in any of those territories. Additionally, it can apply to certain European companies which are listed in the UK. However, it is often forgotten that the City Code also applies to unquoted public companies and even private companies in certain circumstances, most notably where a private company's securities have been marketed or traded in the past 10 years.

#### **Key freedoms where the City Code does not apply**

Where an offer is made for a company to which the City Code does not apply, the parties have considerably more freedom to structure the deal and negotiate as they see fit. For example:

- The City Code restricts the ability of parties to build a controlling stake in a company and can force the offeror to make an offer for the entire share capital in certain circumstances. This does not arise where the City Code does not apply.
- A basic principle of the City Code is that the offeror must treat all of the shareholders equally and the City Code places restrictions on special deals for certain shareholders. Where the City Code does not apply, the offeror is generally free to approach individual shareholders as it sees fit and may offer a different price to each (although note the comments below regarding the "squeeze-out" criteria).
- The City Code places limits on the number of shareholders who may be approached prior to the announcement of an offer to seek their irrevocable undertaking to accept the offer. No such limits arise where the City Code does not apply.
- The City Code restricts the ability of an offeror to withdraw from an offer once it is firmly made. Conversely, if the City Code does not apply, an offeror can withdraw at any time if the conditions of its offer are not met.
- The City Code sets out rules on the level and form of consideration to be offered by an offeror in certain situations, eg where the offeror has acquired shares during the twelve months prior to the offer period. No such constraints arise if the City Code does not apply (although, again, see the comments on "squeeze out" criteria).
- The City Code sets out a timetable for progress of an offer to which the offeror must abide. Where the City Code does not apply an offeror can choose its own timetable.
- The City Code sets out detailed rules on what the offeror must disclose in relation to its offer and the information that must be included in the offer document. If the City Code does not apply, certain more limited disclosure requirements still arise (eg under the UK Companies Act, if the target is a public company an offeror must disclose when its shareholding passes 3 per cent.) but there are no specific content requirements for the offer document.

### **Other issues to consider even if the City Code does not apply**

An offeror will also need to think carefully about the structure of its takeover offer for a variety of other reasons including:

- There may be restrictions in the articles of association of the target or in any shareholders' agreement between the shareholders of the target on transfers of shares especially where control of the company would pass.

- The articles of association or shareholders' agreement may give so-called "drag along" and/or "tag along" rights. If an offeror wishes to take advantage of a drag along right, it will need to ensure that its offer falls within any requirements set out in the relevant article or contractual provision. At the same time, offerors must beware trying to obtain control without observing any rights afforded to minority shareholders under a tag along provision.
- Company law provides that where an offeror acquires 90 per cent. or more of the shares for which the offer is made, it may be able to use a statutory procedure known as "squeeze-out" to force the remaining shareholders to sell their shares. However, there are specific criteria which must be fulfilled to give rise to this right and care will need to be taken to ensure that all of the criteria are satisfied. In particular, the offer must relate to all of the issued shares (or, if the offer only relates to one class of shares, all of the issued shares in that class) other than those already held by the offeror; it must be made on the same terms (ie special deals for certain shareholders will negate the use of the "squeeze-out"); irrevocable undertakings to accept the offer must have been given for no consideration if the shares to which they relate are to count towards the 90 per cent. and special rules exist for convertible securities. It should also be noted that the interim regulations introduced to implement the Takeover Directive prior to the passing of the Companies Bill have amended the "squeeze-out" provisions slightly in relation to targets whose voting securities are admitted to a regulated market (eg. the Official List but not AIM), although these changes will be extended broadly in the same form as the interim measures to all other English companies when the Companies Bill comes into force. The variations include different time periods within which the 90% acceptance level must be achieved and the fact that "negligible" value can be paid for irrevocable undertakings without taking the relevant shares outside the 90% threshold.
- The making of an offer for shares may constitute a "financial promotion" under financial services law. If this is the case, the offer needs to be issued or approved by an authorised person unless an appropriate exemption applies. There are several exemptions that may be relevant, although certain of them require strict conditions to be fulfilled.
- European and/or UK competition law issues may arise if the takeover will give rise to a market concentration which is judged by tests relating to, for example, the turnover or market share of the entities involved.
- Where the target business is regulated in some way (e.g. by the FSA) prior consent may be necessary to a change of control.
- As with City Code regulated takeovers, an offeror may be held liable for any misrepresentations which it makes.

## **Conclusion**

It should be clear from the above that even where the City Code does not apply offerors must tread carefully. Additionally the City Code can apply to surprisingly modest companies such as companies which become a 'PLC' to reassure customers and suppliers or companies which were taken private in recent memory. Takeovers require careful planning and it is important that professional advice is obtained at all stages. A good understanding of the rules, even in private company situations, can provide a potential bidder or a dissenting minority with a significant tactical advantage.

This note is a summary only, does not constitute advice and may not be relied upon.

**For further information on “Takeovers – How the rules are relevant to SMEs”, please contact Stephenson Harwood either Ben Mercer, 020 7452 4230 or [ben.mercer@shlegal.com](mailto:ben.mercer@shlegal.com); or Tony Edwards, 020 7809 2110 or [tony.edwards@shlegal.com](mailto:tony.edwards@shlegal.com)**