ICAEW CORPORATE FINANCE FACULTY

PUBLIC TO PRIVATE TRANSACTIONS

BEST – PRACTICE GUIDELINE 68

Authors: Joseph Katz and Jon Raggett, PwC
Spencer Summerfield and Chris Hale, Travers Smith

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Foreword

This best-practice guideline, devised and commissioned by ICAEW's Corporate Finance Faculty and published with PwC and Travers Smith, looks at a hugely important type of corporate transaction. Public to private ('PTP') deals have continued to grow in significance in recent years as a vibrant part of the M&A market. For example, in seven months to 31 July 2021, there had already been 105 PTP transactions around the world – worth a total value of $166.1bn, according to Refinitiv.

The guideline details many of the practical and regulatory aspects that companies and investors need to consider in PTPs – all of which require very sophisticated corporate finance advice in order to ensure success.

The faculty would like to thank Joseph Katz and Jonathan Raggett and their colleagues at PwC, and Chris Hale and Spencer Summerfield and their colleagues at Travers Smith for their expert authorship of the publication.

The guideline appears at a time when the M&A markets have been very busy, and also when major reviews and reforms of capital markets are underway across the world – not least in the UK.

The Corporate Finance Faculty has been at the forefront of representation and public-policy consultations with government, regulators and market participants about a wide range of subjects, including the Lord Hill's review of the UK's listings regime, potential new powers for the Competition & Markets Authority, the National Security & Investment Act 2021, state-aid policy and the UK's National AI Strategy.

This best-practice guideline from the Corporate Finance Faculty is intended for corporate finance and legal advisers, as well as principals in private equity and public companies. I trust you will find it useful.

David Petrie

Head of Corporate Finance
ICAEW

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Introduction

The purpose of this best-practice guideline is to provide an overview of a public to private ('PTP') transaction in the UK. It is not intended to cover more general considerations relating to public offers, although many of the considerations will be relevant to UK public offers in general.

This guideline reflects the rules on public takeovers in effect on 5 July 2021.

WHAT IS A PTP?

A PTP is an acquisition of a public company (listed or unlisted) by a new company funded by some combination of equity from a private equity fund, infrastructure fund, individuals and/or a family office and, typically, debt finance. In many cases, a PTP transaction can be driven by the management team of the public company, who may, with the permission of the board, approach potential providers of finance to fund a PTP.

PTPs are high-risk transactions with many strategic and tactical issues, regulatory and legal requirements, and different groups of stakeholders to be managed. These need to be considered from a very early stage, so parties should consult early on with experienced financial and legal advisers.

THE REGULATORY ENVIRONMENT

The City Code on Takeovers and Mergers (the 'Code') will generally apply to an acquisition of a UK public company. The Code is based on six General Principles, 38 rules and a number of Practice Statements. It is written in a straightforward rather than a technical or detailed legal style and it is of critical importance that the spirit as well as the letter of the Code is followed.

The Panel on Takeovers and Mergers (the 'Panel') is responsible for issuing and administering the Code and for supervising and regulating takeovers, mergers and other transactions to which the Code applies. The Panel seeks to ensure compliance with the Code through a consensual approach, and in practice parties to a PTP will consult with the Panel frequently throughout the process.

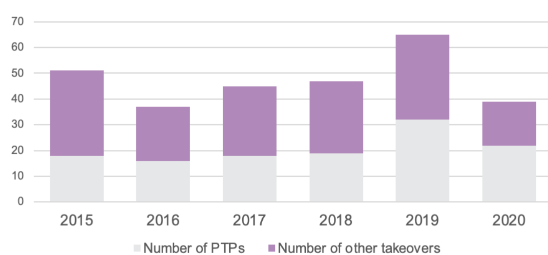
The Panel has legal powers to obtain documents and information and, in certain circumstances and on rare occasions, to seek enforcement of a Panel ruling through the courts. This has been seen most recently in the legal action taken in 2018 by the Panel to enforce compliance with the Code by David King in relation to Rangers International Football Club PLC.

For listed companies, the ongoing requirements of the Listing Rules, Disclosure and Transparency Rules, the Market Abuse Regulation and the AIM Rules, as applicable, will also need to be considered. There may also be other legal or regulatory requirements if the company has a listing outside of the UK.

THE PTP MARKET

There is a well-established market in UK PTP transactions, and over the past five years there have typically been between 20 and 30 completed PTPs each year (see figure 1), representing a significant proportion of UK public takeover activity.

Figure 1: UK takeovers and PTPs



*Takeovers that subsequently completed, by year of announcement. Source: PwC research

PTP activity is predominantly focused on small – mid cap companies. However, there are some notable examples of very large scale PTPs, such as the £3bn PTP of Sophos Group plc backed by funds managed by Thoma Bravo, announced in 2019 and, going back to 2007, the £10.6bn PTP of AllianceBoots backed by Kohlberg Kravis Roberts. At the time of writing there were also a number of larger possible PTPs being discussed, including a potential £6bn+ PTP of Wm Morrison Supermarkets plc. Larger scale public takeovers tend to be dominated by strategic acquirors, for example the £78.4bn offer for SABMiller plc by Anheuser-Busch InBev SA/NV.

Hostile takeovers, being offers which do not receive a recommendation from the board of the target, are rare in the UK market, although a more common situation is for an initial hostile approach to lead to a recommendation being secured at a later point in discussions. It is very rare for a PTP to be hostile given the challenges that this presents in terms of conducting due diligence that would be required by the providers of funding for the offer.

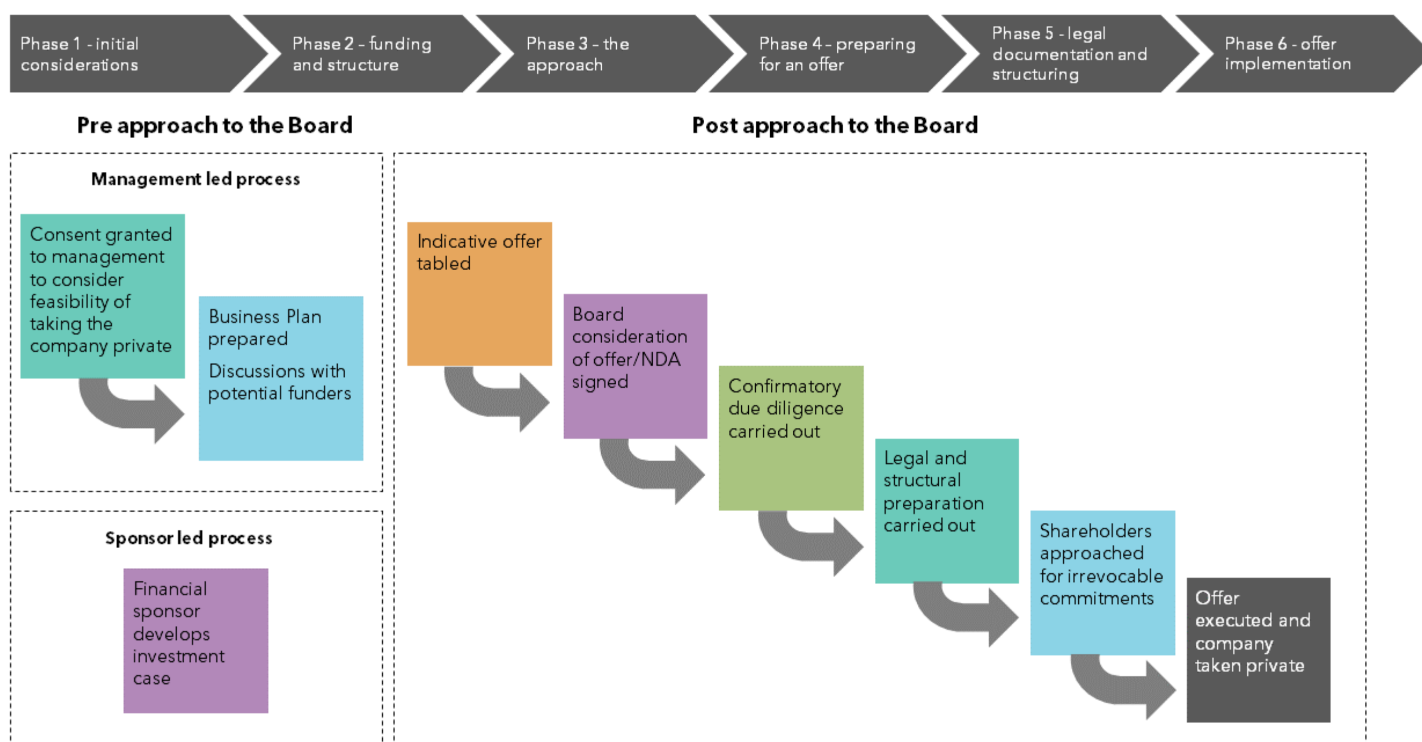
The level of PTP activity tends to be correlated with the level of wider M&A activity, although there are a number of specific factors that drive PTP activity levels, including:

- availability and terms of debt financing;
- valuations of listed companies, both absolute and relative to private company valuations;
- the regulatory environment for listed companies and the associated administration and costs;
- availability of equity financing to listed companies to fund organic growth and acquisitions; and
- specific sector trends driving interest from financial sponsors in particular types of businesses.

Overview of the PTP process

Set out below is an outline of the key steps in a PTP process. The initial steps will depend on whether the process is being led by the management team or by a financial sponsor. If it is a management led process then, once the management team have decided that they wish to explore a PTP in a more formal way (such as by appointing their own advisers), they should first obtain consent from the independent directors of the target to pursue this course of action, including permission to release target company information to potential funders under a confidentiality agreement, and to spend time in developing a business plan with a financial sponsor. In the event that a target company board initiates a PTP process by approaching financial sponsors, the target should consult with the Panel before approaching more than one potential bidder.

Figure 2: The PTP process



PHASE 1 – INITIAL CONSIDERATIONS

In assessing the feasibility of a PTP, the management team or a potential acquiror will typically start by looking at a number of factors that determine the potential risks and rewards of a transaction. This is particularly important in a PTP given the high execution risks driven by the inability (except in very limited circumstances) to secure any deal protections from the target company for the potential bidder (such as exclusivity, non-solicitation undertakings or break fees); the significant costs of a deal; and the risks of a competing bid or a rejection of a bid by shareholders.

Share price

The market will generally expect an offer to be priced at a premium of at least 25-50% to the prevailing share price prior to a bid being announced, although other pricing and valuation metrics will also be relevant. The offer price and recent trends in the share price compared with the entry price of key target shareholders will be important in assessing the attractiveness of an offer.

A bid made in the context of a share price that has declined significantly may be viewed as opportunistic by the target board and the target's shareholders. Conversely, a rising share price can erode the premium, making an offer seem less attractive by the time of announcement.

Share price targets issued by research analysts and the share price performance of comparable companies will also be key benchmarks.

Valuation metrics

The target board and its shareholders will consider the terms of any offer in light of the fundamental valuation metrics compared to benchmarks for comparable listed companies and transactions. In this context it will be important to understand whether the company looks under- or over-valued and the ability to offer an attractive premium to the current share price. The bidder will also want to formulate the valuation arguments that would be made to the target company board and shareholders.

Key metrics are likely to include enterprise value ('EV') to earnings before interest, tax, depreciation and amortisation ('EBITDA') and share price to earnings per share ('P/E'); as well as sector specific metrics such as the premium or discount to net asset value ('NAV') for real estate businesses or listed investment companies/trusts.

Board and management

The target board's response to an approach will be an important determinant of the success or otherwise of an offer. The vast majority of successful offers[1] receive a recommendation from the board of the target to the target's shareholders to accept the offer, and also benefit from the active cooperation of the target board throughout the preparation for a bid, including the provision of access to due diligence information.

A management team that can continue in place after a bid, driving a growth plan, will represent a significant positive for almost all financial sponsors. In cases where a PTP is being driven by a management team, the team may have views on an alternative plan for the business under private ownership that would not be feasible as a public company.

1 In 2019 there were five hostile bids. In 2020 there was one hostile bid.

Activist shareholders

Target shareholders will ultimately need to accept or approve any offer that is made, so the make-up of the share register must be reviewed to determine the likely attitude of shareholders to an offer. Certain activist shareholders may seek to block a bid or may proactively seek out higher bids from competing bidders. Similarly, competing trade buyers may seek to block a bid by building a stake, or they may have built a stake in the past.

It is now relatively common for the share register of a target company to change after a bid or potential bid is announced, with merger arbitrage funds building stakes, seeking to benefit from any discount in the share price compared to the offer price and/or to benefit from a revised or competing offer.

'Bumpitrage', increasingly a feature of the public M&A landscape, is the practice of buying a stake in a target company and then exerting pressure on a bidder to improve its offer. Such pressure is easier to exert on a contractual offer, where the activist may be able to prevent the bidder from obtaining the 90% acceptances of the offer required to 'squeeze-out' the remaining 10%. But even where the takeover is implemented by way of a scheme of arrangement, an activist may be able to rally other shareholders to threaten the success of the bid. This strategy was employed by Elliott Management in 2016, who bought into SAB Miller and extracted a higher offer from AB InBev.

Shortly ahead of an offer announcement (it is normally more challenging for this to occur earlier on in the process), it is common practice for a bidder to approach key target shareholders to seek irrevocable undertakings to accept the offer. It is helpful to understand whether larger shareholders will typically provide such undertakings and the terms under which they may be provided.

Stake building

A potential bidder may wish to consider purchasing shares in the target in order to gain a tactical advantage. This tactic should be considered at an early stage as there are a number of important restrictions and implications associated with share buying in the context of an offer.

Rule 9 of the Code means that a party (together with its concert parties) is generally restricted to acquiring an interest in shares of less than 30% unless it is prepared to make an immediate all-cash offer for the target with no conditions other than a 50% acceptance condition.

A potential bidder will need to be mindful of the restrictions under the Market Abuse Regulation if it is in possession of inside information. Under the Code, any share purchases can also have implications for the pricing and terms of any eventual offer.

Further details are set out in the 'Share buying' section under Other Considerations.

Competing bidders

The population of possible competing bidders, and their likely ability and willingness to offer a premium valuation for the target will be key, given it is very difficult to effectively commit a target company to a transaction pre- or post-offer announcement. A bidder will want to be confident at an early stage that there are few alternative bidders or that it is well placed to be able to outbid any competitors that consider a counterbid.

Financial sponsors may be wary about looking at targets where there is a large pool of potential strategic buyers that could realise significant synergies.

An approach from a potential bidder may prompt the board of the target to consider other strategic options, which may result in discussions with an alternative bidder. It is also the case that a competing bidder may emerge after a deal is announced. For example, in April 2019 Universities Superannuation Scheme Limited ('USSL') announced a recommended offer for KCOM Group plc. A competitive situation arose with a higher offer from Macquarie Infrastructure and Real Assets ('MIRA') being announced in June 2019 and the KCOM board changing its recommendation. As neither bidder had declared their offer final, the Panel put in place an auction process which resulted in a winning bid from MIRA at a premium of 17% to the original USSL offer.

Pension funds

An added complication for a PTP is the existence of any defined benefit pension scheme. Consultation with the pension fund trustees may be required and engagement with the Pensions Regulator is also often necessary.

The trustees will want to assess whether the proposed transaction may weaken the employer's covenant, particularly in the case of a leveraged bid, and may require additional contributions or security to mitigate any detriment. In assessing the scale of such mitigation, the specific circumstances of the target and the scheme will need to be carefully considered, particularly the scheme's funding level, which may differ significantly from the accounting deficits set out in the published financial results. Specialist advice should be taken early on in any process and any likely contribution requirements factored into the evaluation of the target.

Costs of a PTP

PTPs can be high-cost transactions, particularly if a leveraged buy-out ('LBO') structure is used. It is also the case that the target's costs will necessarily be funded out of the target's cash resources, so will effectively be borne by the bidder.

Figure 3: Typical categories of costs for a PTP funded through a leveraged buy-out structure

COSTS FOR THE BIDDER

- Financing fees – debt
- Financing fees – equity
- Financial adviser
- Broker (if required)
- Legal adviser to bidder
- Legal adviser to the financial adviser
- Public relations adviser
- Due diligence advisers
- Stamp duty
- Panel fees
- Auditors/reporting accountants (if required)
- Tax advice
- Printers and receiving agents (registrars)
- Management team advisers

COSTS FOR THE TARGET

- Financial adviser (the Rule 3 adviser)
- Legal adviser
- Broker
- Break costs on debt facilities

Regulatory approvals and other authorisations

Regulatory consents required will need to be factored into the analysis of the feasibility of a PTP and the timetable. For example, a change of controller of a financial services business may require approval from the Financial Conduct Authority (FCA) or the Prudential Regulation Authority, and there may be overseas regulators that will need to approve the transaction. Clearance may also be required under legislation eg, the National Security and Investment Act 2021.

At an early stage, the potential bidder (as well as the target board) will want to understand the prospects of successfully obtaining the necessary regulatory consents and the timetable for securing them.

The Code requires that an announcement of a firm intention to make an offer under Rule 2.7 should only be made if the offeror has every reason to believe that it can and will continue to be able to implement the offer. In this regard, a bidder will want to have a high degree of visibility on securing the necessary regulatory consents.

A potential bidder that makes an offer subject to regulatory approvals will need to be aware that the Panel will need to consent to invoking any condition to an offer. The Panel has a very high threshold – the circumstances which give rise to the right to invoke the condition must be of material significance to the offeror in the context of the offer.

A bidder may request suspension of the timetable if any official authorisation or regulatory clearance is outstanding by the second day prior to day 39 and if either both parties agree or the bidder can show that the authorisation or clearance is of material significance.

PHASE 2 – FUNDING AND STRUCTURE

Funding

At an early stage, the potential bidder will need to determine how any PTP will be funded. In addition to the offer value, there is likely to be a requirement to refinance any existing debt facilities in the target. The costs and fees (both of the bidder and the target) will also need to be funded.

A management team that is considering a PTP will need to give careful thought to the identity of financial sponsors it talks to, given the restrictions under the Code (Rule 2) on the number of parties that can be approached without an announcement or the consent of the Panel (no more than six excluding immediate advisers). An experienced financial adviser can provide valuable insights on the funds that are most likely to have an interest in the opportunity and the house style of each of the funds and the fit with the management team.

Due diligence access

There may be limited due diligence access, at least in the early stages of a PTP, given the need under the Code (Rule 21.3) to provide equal access, when requested, to such information to all bona fide bidders. The release of commercially sensitive information to trade competitors could be detrimental to the target's business.

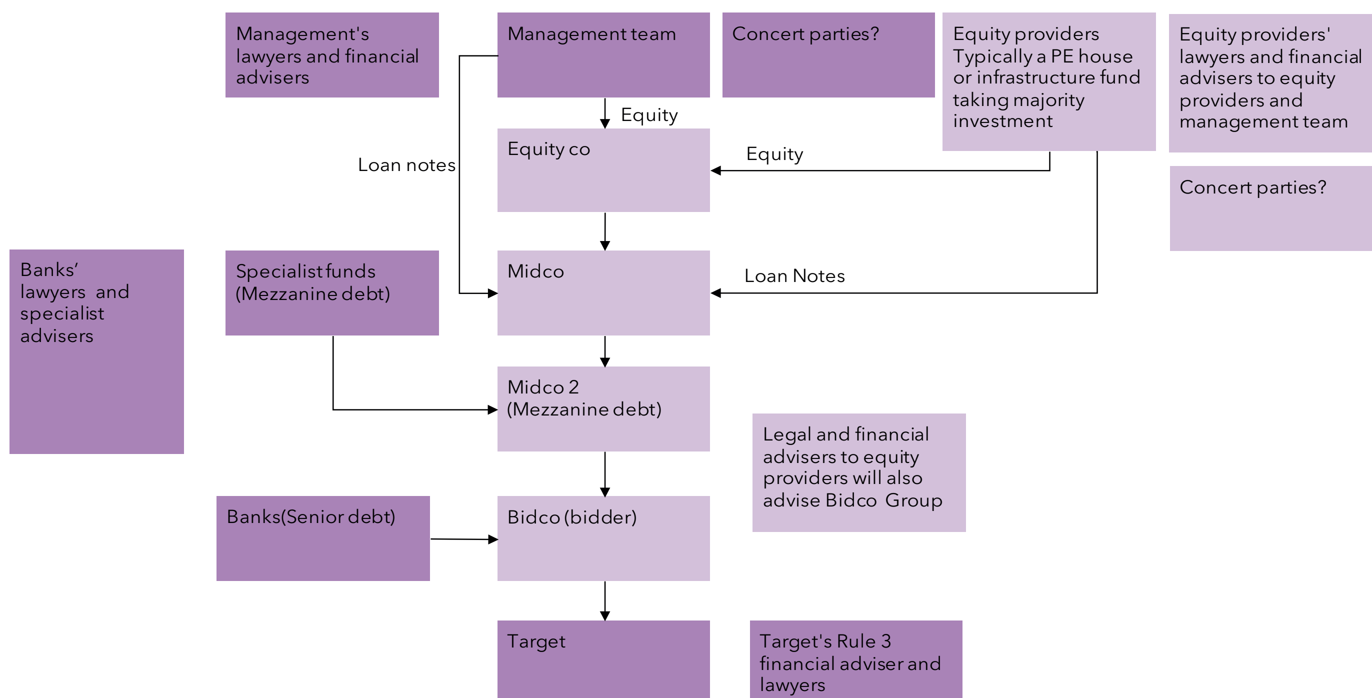
Leveraged buy-out returns

A financial sponsor will want to take a view at an early stage on whether or not a PTP opportunity is likely to deliver an acceptable level of financial return.

A private equity investor's assessment of a PTP opportunity is similar to the assessment of a private company LBO.

For example, an investor may be looking to target a return of at least two times its initial investment over a five-year hold period. A number of assumptions will need to be made in order to assess the likely returns from the investment, including the level of offer premium required, the existing debt in the target requiring refinancing, the level of acquisition debt that can be raised, the profitability and cash flow profile of the target in the future and the valuation on exit. The financial adviser to the potential bidder will usually take the lead in developing an LBO financial model which will enable returns to be assessed as key assumptions are flexed.

Figure 4: Parties and their advisers



The bidding vehicle will normally be the subsidiary of a 'stack' of companies housing the equity, senior debt and any mezzanine finance. This separation is for tax structuring and debt subordination purposes.

The equity provider (usually a private equity house or infrastructure fund) and the bidding vehicle will have a single legal adviser, and the management team will be separately advised in relation to their participation in the bidder group.

The target must obtain independent financial advice under Rule 3 of the Code. The requirement for competent independent advice is of particular importance in a PTP, where the independence of the adviser for the independent directors must be beyond question. Furthermore, the responsibility borne by the financial adviser is considerable and, for this reason, the target's board should appoint an independent financial adviser as soon as possible after it becomes aware of the possibility that an offer may be made.

Concert parties

A concert party is a person with whom the bidder cooperates to obtain or consolidate control of a company (or to frustrate the outcome of an offer). Unless this presumption can be rebutted, certain persons are presumed to be acting in concert, including companies with their affiliates and directors, individuals with their relatives and related trusts and fund managers with the portfolio companies that they manage.

Under the Code, the bidder and its concert parties will be treated for certain purposes (such as dealings in the target's shares) as a single person. Therefore, it is essential for the bidder to identify any concert parties at an early stage. A 'concert party analysis' should be carried out in consultation with the Panel in order to settle the scope of the concert party early on.

Joint offerors

In regard to a consortium bid, it will be important to establish that any target shareholder which is part of the consortium will be deemed by the Panel to be a genuine 'joint offeror' so that the arrangements entered into between it and the other consortium members do not amount to a breach of the principle that all the target shareholders should be treated equally. If that party does not have sufficient control and involvement in the bid to be afforded joint offeror status, such arrangements may be in breach of the Code principle of equality, and of Rule 16, which prohibits 'special arrangements' with particular target shareholders.

The following questions are relevant to determine whether a consortium member is a joint offeror, as opposed to a person acting in concert with the bidder:

a. What proportion of the equity share capital of the bid vehicle will the person own after completion of the acquisition?

b. Will the person be able to exert a significant influence over the future management and direction of the bid vehicle?

c. What contribution is the person making to the consortium (beyond its shareholding in the target)?

d. Will the person be able to influence significantly the conduct of the bid?

e. Are there arrangements in place to enable the person to exit from their investment in the bid vehicle within a short time or at a time when other equity investors cannot?

PHASE 3 – THE APPROACH

Tactics

The potential bidder will want to consider a number of factors relating to an approach to the target:

- **Individuals to be approached** – usually the chairperson of the board of directors of the target would be the formal contact for an offer approach, but there may be existing relationships with other members of the board, such as the chief executive, that could be used tactically to build support. This will also depend on the role that the management team are playing in driving the PTP.
- **Timing** – provided strict secrecy is maintained, a potential bidder has control over the timing of an approach and can time it to maximise its advantage. Factors to take into consideration could include recent share price performance, changes in shareholdings, recent financial performance and related announcements, and board and management changes.
- **Nature of the approach** – the majority of potential bidders will want to secure a recommendation of an offer from the board of the target, so will make an approach on a friendly basis. However, certain bidders may be comfortable with a more aggressive approach.
- **Shareholders** – a bidder may wish to approach key shareholders ahead of an approach to the target. This can provide insights into price expectations and supportive shareholders can be used to put pressure on a target board that is reluctant to engage in discussions. However, it can be seen as unfriendly behaviour by a board and shareholders may be reluctant to engage in discussions or to be made insiders.

Indicative offer

An indicative offer letter from the bidder will usually be required by the target board and its advisers before they decide whether or not to grant access to the bidder to conduct due diligence. In addition, the target board will want to understand how deliverable the offer is. It is therefore important that such an offer letter clearly sets out the offer terms, the work conducted by the bidder to date, the remaining steps to announcement of an offer, the main conditions of the offer and the reasons why the board or independent directors should be willing to recommend the terms of the offer to shareholders.

Figure 5:

TERMS OF THE INDICATIVE OFFER

- Headline consideration
  - Price
  - Cash vs shares
- Typical assumptions
  - Current and forecast trading
  - Target's transaction costs
  - Cash/debt position
  - Other liabilities including contingent liabilities
  - Pension position (if applicable)
  - Normal level of working capital
  - Shares in issue/dilution
  - Impact of any change of control provisions
- Valuation arguments
  - Premium
  - Valuation metrics

Figure 5 contd:

OTHER CONTENTS

- Requirement that offer is recommended by target board
- Background to the offer
  - Rationale for the offer
  - Plans for business
- Management
  - Plans for management team
- Due diligence
  - Due diligence request list
- Timetable to announcement of firm intention to make an offer (Rule 2.7) and key pre-conditions to making such an announcement (eg, due diligence access or support to seek irrevocable undertakings)
- Financing (and support letters from any key third party providers of funding)
- Material conditions to the offer (eg, regulatory approvals required)
- Initial analysis of competition issues and other regulatory requirements (if relevant)

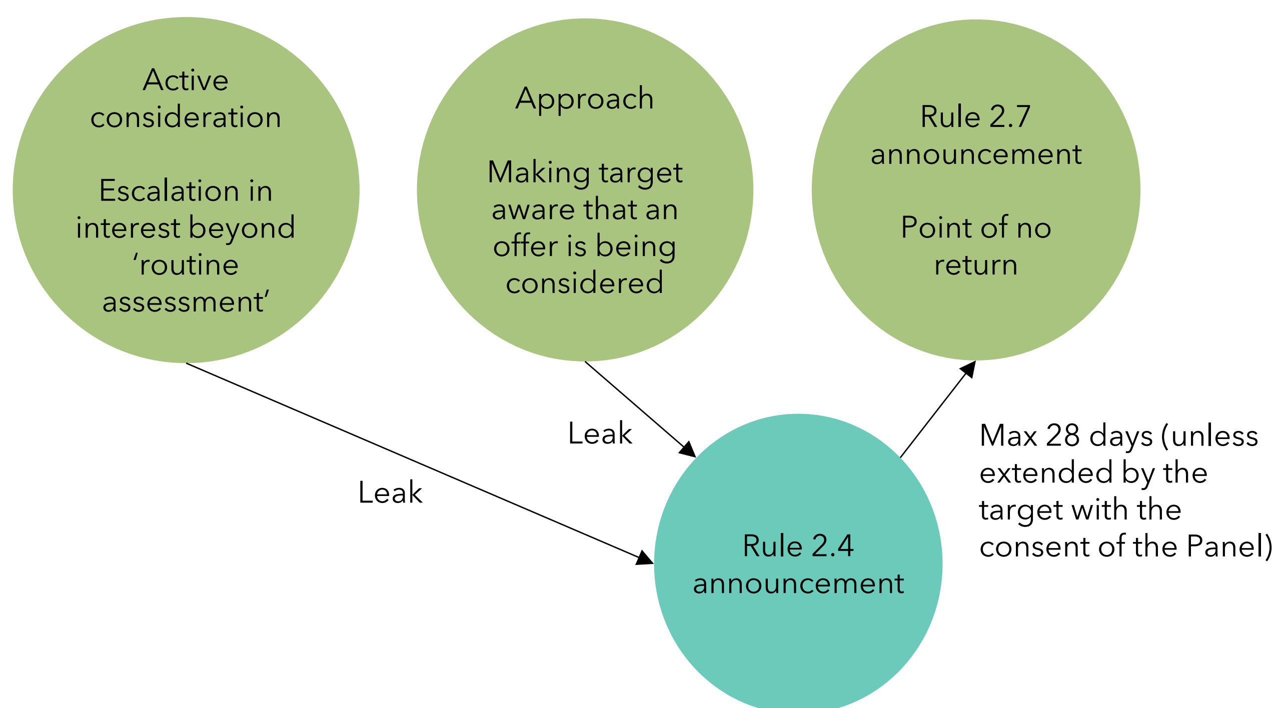
Considerations for the target board

Following an approach, the board (or independent directors as appropriate) will want to understand the proposed terms of the possible offer and, if not already provided, will usually require an indicative non-binding offer letter before granting any due diligence access (see figure 5 for possible contents). The board will then need to consider, in conjunction with the target's financial adviser, whether the proposed terms are recommendable to shareholders and whether they can be improved through negotiations. The target board and its financial advisers will take into account a number of factors which could include:

- **Valuation benchmarks** – the valuation of the business implied by comparable transactions and comparable listed companies
- **Share price premium** – the premium represented by the indicative offer and the likelihood of the company's share price attaining this level in the short- to medium-term
- **Identity of the bidder** – credibility of the bidder, which may include reference to size, experience, access to funding and strategic fit
- **Pre-conditions and conditions** – any pre-conditions to making an offer that could materially impact deal execution risk and the nature of any specified conditions to an offer
- **Value to the bidder** – the returns resulting from an LBO model and the impact of any synergies that could arise from a combination with a similar business in a financial sponsor's portfolio
- **Alternative bidders** – the value of the business to other bidders, which may be able to pay a higher price due to synergies or strategic fit
- **Alternative strategic options** – other ways of achieving value for shareholders, eg, a return of capital, refinancing, sale of parts of the business, acquisitions or a change in strategy

If the board decides that the terms of the indicative offer are acceptable then it may grant access to the bidder for confirmatory due diligence. If the board decides that the terms are not acceptable then it should consider how it will respond should the potential bidder adopt a more aggressive or hostile approach.

Figure 6: Preliminary stages: 'Active consideration' and the 'approach'



Bid defence is outside the scope of this guideline but a key element is management of the communication with shareholders. For this reason, a target board in receipt of an approach from a potentially hostile bidder may wish to consider having discussions with key shareholders ahead of rejecting the approach.

'Active consideration' is the first stage at which the Code will become relevant. As it is normal for corporate executives, financial sponsors and business development personnel to consider M&A opportunities and run desktop analyses on potential acquisition targets, this alone is unlikely to be 'active consideration'; nor should general scoping conversations with bankers and lawyers constitute 'active consideration'. However, the engagement of a deal team for a specific deal (even before any engagement letters are signed) and/or speaking to other external parties (see 'Rule of six' below) is likely to be enough.

An approach to the target is considered to have been made when a director or representative of, or an adviser to, the target is informed by, or on behalf of, a potential bidder that it is considering the possibility of making an offer for the target. This may be at a very preliminary stage in the potential bidder's preparations and the manner of the approach may be informal and no more than broadly indicative. For example, there is no requirement for an approach to be made in writing, or for an indicative offer price (or any terms or conditions) to be specified, and even the briefest communication can be deemed by the Panel to constitute an 'approach'.

As described above, it is typical for the bidder to send an indicative offer letter to the target board, setting out bid parameters in order to secure a recommendation from the target board. However, it does not have to be a formal letter: a dinner conversation with a single director may be enough. A bidder should always take advice before any form of approach to target personnel or their advisers.

The Code requires that the Panel is consulted in circumstances where there is a material (10% or more above the lowest share price since the commencement of active consideration) or an abrupt share price movement (5% or more in a single day) or where there is rumour and speculation in relation to the target. Following the commencement of active consideration but before an approach, this requirement is the obligation of the potential bidder and appropriate procedures should be put in place to monitor real-time share price movements and any rumour or speculation. Following the approach to the target, the obligation passes to the target. If an announcement is required, it triggers a 28-day 'Put Up or Shut Up' ('PUSU') timetable after which the bidder must announce a firm intention to make an offer or withdraw from making an offer for at least six months. The 28-day PUSU period can be extended with the consent of the Panel. In practice, the Panel will consent if the target is agreeable to such an extension (see figure 6). Such an announcement by the target must also identify any other potential offerors.

Secrecy

Secrecy before an announcement is of vital importance and the risk of leaks must be minimised. All persons who are privy to confidential information concerning an offer or possible offer must conduct themselves so as to minimise the chances of any leak of that information (Rule 2.1(a)). In the event that there is a leak of information then the Panel may require an immediate announcement to be made (which would commence the 28-day PUSU period referred to above) and will wish to learn of the procedures and controls that were put in place to maintain the confidentiality of information.

The rule of six

The Panel should be consulted prior to more than a total of six external parties (beyond advisers and bidder personnel) being approached about an offer or possible offer including: potential providers of finance (whether equity or debt); investors in the sponsor; shareholders in the target; the target's pension fund trustees; potential management team candidates; significant customers of, or suppliers to, the target; potential purchasers of assets; and rating agencies.

Where an equity or debt provider is no longer interested in the proposed offer, the Panel may allow this party to be no longer counted as one of the six. One consequence of extending information concerning an offer to more than a very restricted number of people outside those who need to know in the companies concerned and their immediate advisers is that the Panel may require a public announcement.

Specific considerations for a management team looking to lead an offer

A management team that is contemplating an offer should bear in mind the following:

- their duty to continue to act in the best interests of the target and continue to do their day job;
- in any exploratory talks, complying with the 'rule of six' (see above);
- not sharing confidential information with finance providers or any other party unless and until the independent directors of the target board consent; and
- that the bid is likely to constitute inside information and unauthorised disclosure or dealing in the target shares on the basis of such information may be an offence under the market abuse regime.

Split of the board/keeping the board together

Provided the independent directors have agreed to the buy-out proposal being put together, there is no problem in principle with members of the management team continuing as directors of the target while the offer is in contemplation or being implemented.

The transaction will be run on behalf of the target by a committee comprising the independent (ie, non-management team) directors. Once the target board splits into the management team and the independent committee, the responsibilities of the two groups during the process will differ, as shown in figure 7.

The management team directors should note that in carrying on the target's business, decisions must be taken having regard to the interests of the target and not those of the management team, the financial sponsor or the proposed bidder.

The appointment of a committee of independent directors of the target does not relieve the members of the management team who are directors of the target from their directors' duties or their duties under the Code. In particular, they retain their duties to accept responsibility for documents issued to the target shareholders (excluding any recommendation given by the independent directors of the target to accept the offer from the bidder) and not to take any frustrating action (which could be relevant in the event of a competing offer to that proposed by the management team being made).

Figure 7: Respective responsibilities of the management team and the independent directors

INDEPENDENT DIRECTORS

- Give management approval to consider feasibility of taking the target private
- Control flow of target information to the financial sponsors (together with legal and financial advisers)
- Have an obligation to deal with competing bona fide third party bidders
- Maintain secrecy
- No share dealings
- Determine, together with the appointed financial adviser, whether the offer is 'fair and reasonable' and state the terms of management's participation in Newco are 'fair'
- Responsible for certain information in the offer document
- Abide by the Code

Figure 7 cont'd:

MANAGEMENT INVOLVED IN THE BUYOUT

- Continue to be responsible for the management of the business
- Develop business plan
- Maintain secrecy
- No share dealings
- May be parties to the subscription and shareholders agreement (giving warranties)
- New employment contracts
- Responsible for certain information in the offer document
- Abide by the Code

PHASE 4 – PREPARING FOR AN OFFER

Confirmatory due diligence

Following the initial desktop due diligence early in the process, the potential bidder will want to carry out confirmatory due diligence, during which time more detailed information will be made available by the target.

The extent of any due diligence exercise to be carried out on the target group will need to be approved by the independent directors of the target. The management team alone does not have authority to approve the scope and indeed must not hand over any confidential information relating to the target, except with the approval of the independent directors.

The purpose of the due diligence exercise is to enable the financial sponsor to confirm the price that it is willing to pay for the target's shares. Any due diligence exercise is likely to involve financial, legal, commercial, actuarial (if the target has a defined benefit pension scheme), insurance, and possibly environmental and regulatory due diligence. The scope of the due diligence exercise will vary according to circumstances and will generally be more limited than on a private acquisition, but in recent years, particularly due to the demands of financial sponsors, a more extensive scope has become typical.

Companies will normally want to delay the disclosure of certain highly sensitive information to a financial sponsor until late in the process. The reason for this is Rule 21.3 of the Code which requires that any information the target provides to a financial sponsor or proposed debt providers must also be disclosed to any other bona fide bidder that requests the same information.

Whereas a target may not mind a financial sponsor seeing certain information, it may not want to disclose that information to, say, a competitor in the same or similar business. Disclosure of such sensitive information is therefore often left until much later in the due diligence process.

Certain information may not be able to be provided directly to a bidder, particularly in situations where the sharing of commercial information between business competitors may have competition law consequences. Where such information is necessary for the bidder and its advisers to assess whether competition or other regulatory clearances are necessary, the information may be passed on to a 'clean team' of external advisers and non-business individuals at the bidder.

Specific information sharing provisions for MBOs

Rule 21.4 of the Code states that, in the case of a management buy-out ('MBO'), the bidder or a potential bidder must, if requested, give to the target's independent directors and the financial advisers all information which has been given by the bidder or a potential bidder to external providers or potential providers of finance for the buy-out.

The Panel has stated that this includes information on the target generated by or with the assistance of the target's management, eg, the bidder's business plan or the due diligence reports prepared by the management team's professional advisers. In cases of doubt, the Panel should be consulted. This information is not however required to be provided to any other bona fide bidder.

Irrevocable undertakings

Given the execution risk inherent in a public bid, ensuring that significant shareholders are supportive is a key consideration. Therefore, irrevocable undertakings are usually sought from significant shareholders in the target and the directors of the target just prior to the announcement of a firm intention to make the offer. The persons giving the undertaking agree to accept the takeover offer or, in the case of a scheme, to vote in favour of the scheme. As target shareholders have withdrawal rights under the Code, irrevocables also contain an undertaking that the relevant shareholder will not exercise those rights to withdraw its acceptance.

Irrevocables are typically either 'hard' irrevocables (where they do not fall away unless the PTP lapses) or 'soft' irrevocables (where the undertaking to accept the offer or vote in favour of the scheme ceases to apply if a competing higher offer is made or announced within a specified period of time). Semi-hard irrevocables will provide that they will only fall away if a competing bidder makes an offer at a price that is more than x percent above the PTP offer price (where x is typically five or ten percent). Some institutional investors have a house policy of only giving soft irrevocables. Investors who are reluctant to give an irrevocable undertaking may instead give a non-binding letter of intent.

Where shareholder directors are asked to give irrevocable undertakings in respect of their shareholdings, these undertakings cannot be used to circumvent the rules against deal protection by way of 'offer-related arrangements' (see Offer-related arrangements). The Panel has published a Practice Statement (Practice Statement 29) setting out terms which must not be included in directors' irrevocables, including obligations not to seek competing bids.

The process by which the bidder approaches the target shareholders seeking irrevocable undertakings is regulated by the Code and the Market Abuse Regulation.

Under Rule 20.2, any meeting with target shareholders (other than those who are the target directors) will typically need to be attended by the bidder's financial adviser, who must confirm to the Panel that no new information or significant new opinion was shared with the shareholder or, if the meeting takes place before the bid is announced, that any new information or significant new opinion provided to the shareholder will be published when the offer is announced.

The Panel may grant a dispensation from the chaperoning requirement in the case of a recommended offer with no competing bid, subject to the financial adviser giving an appropriate briefing to the representatives of the bidder or target who will attend the meeting, and those representatives making the same representations to the Panel as the financial adviser would have made.

An approach to shareholders in respect of the bid will constitute a 'market sounding' under the Market Abuse Regulation which sets out a prescribed process in order to benefit from a safe harbour preventing communications with target shareholders constituting an unlawful disclosure of inside information.

Post-offer intention statements

Under the Code, a bidder is required to state its intentions for the target business for the 12 months following completion on various matters, including the impact of its offer on employees, pension schemes and places of business.

These intentions are required to be disclosed at the time of the firm offer announcement under Rule 2.7, in order to give stakeholders (and the government) an opportunity to comment on these intentions.

These statements of intention are not binding but, under Rule 19.6, must comprise an accurate statement of the bidder's intentions at the time and be made on reasonable grounds. The recent changes to the Code show an increased focus by the Panel on specificity in these statements, with further information required on a bidder's plans for R&D, or changes to the 'balance and skills' of the target's workforce. In circumstances where a bidder has quantified the synergies expected from the transaction, the Panel will expect any employee headcount reductions also to be quantified (on the basis that the bidder will know the information because at least some of the synergies will be derived from these reductions).

If, following its offer, the bidder does not take any of the actions it stated it intended to take, or takes a different course of action, it is required to make an announcement of this fact promptly. In addition, at the end of the 12-month period following completion of its offer, the bidder will be required to make an announcement stating whether it has taken, or not taken, the course of action specified in its intention statements.

Post-offer undertakings

Under Rule 19.5 and subject to consultation with the Panel, a bidder may choose to make a post-offer undertaking (a 'POU'). Rule 19.5 of the Code sets out the content and other requirements for a POU, including that:

- a time period for the POU be specified (normally no more than five years);
- the POU be specific and precise;
- the POU be readily understandable and capable of objective assessment (and not depend on the subjective judgement of the bidder's directors); and
- any conditions or qualifications to the POU be prominently stated.

Following completion of the takeover offer, the Panel takes on the role of policing the POUs. It can (and typically will) require a bidder to appoint (at its cost) a supervisor to oversee the bidder's compliance with its POUs and progress reports must be published every 12 months. If a bidder does not comply with its POUs, the Panel has the power to

require enforcement, including through the courts if necessary. This being the case, POUs often require extensive discussion with the Panel before being put in place.

POUs are increasingly seen as the price for regulatory approval of takeovers in regulated and sensitive sectors, and where there is significant public interest. Such undertakings have been given by Softbank on its bid for ARM, Comcast in relation to Sky, Melrose in relation to GKN and Advent in relation to Cobham.

The National Security and Investment Act gives the UK government increased powers to 'call-in' and/or investigate acquisitions across a number of market segments. It is quite possible that increased powers to challenge inward investment on national security grounds will decrease reliance on POUs as a means of controlling foreign investment in politically or strategically sensitive areas.

PHASE 5 – LEGAL DOCUMENTATION AND STRUCTURING

At an early stage in the process the bidder will need to decide whether the bid should be structured as a contractual offer or a scheme of arrangement. The principal factors in that decision are set out in figure 8.

Figure 8: Comparison of a scheme of arrangement and a contractual offer

KEY ISSUE	SCHEME OF ARRANGEMENT	CONTRACTUAL OFFER
Control of process	The scheme process is controlled by the target	The bidder controls the offer process
Suitable for hostile offer	Due to the co-operation required from the target a scheme is unlikely to be possible	Yes
Stakebuilding	Shares acquired by the bidder (either pre- or post-announcement) are not able to vote at the shareholder meeting to approve the scheme	Shares held/purchased in advance of receipt of the offer document by target shareholders will not count towards squeeze-out Possible to structure so that any shares acquired post sending the offer document to the target shareholders do count
Timing	Although a contractual offer can be declared unconditional at an earlier stage, schemes allow the bidder to get to 100% more quickly	Ability to declare unconditional earlier (with 50.1%) but overall process to get to 100% slower

Figure 8 contd:

KEY ISSUE	SCHEME OF ARRANGEMENT	CONTRACTUAL OFFER
Threshold for avoiding a minority	Approval by shareholders (a) holding at least 75% in value of shares voted and (b) being a simple majority in number of those voting	90% threshold to squeeze-out minorities
Prospectus Regulation Rules requirement for consideration shares	No (unless there is a choice of consideration due to a 'mix and match' facility in which case a prospectus may be required)	May trigger a requirement for a prospectus (or equivalent document)
Court sanction required?	Yes – potential for objections due to requirement for court sanction	No

On a contractual offer, the bidder offers to purchase the target shares from each shareholder individually. A scheme of arrangement, on the other hand, is a statutory process by which the target applies to the court to sanction an arrangement by which the target shares are transferred to the bidder. Such a scheme must first be approved at a meeting of the target shareholders by a majority in number, holding at least 75% in value of those shares voted at that meeting. Once the scheme of arrangement is approved by the target shareholders and sanctioned by the court, all the target shares subject to the scheme will transfer to the bidder.

The majority of medium to large PTPs are now structured by way of a scheme of arrangement (75% between 2018 and 2020), largely due to the increased certainty and speed in getting to 100% control. Previously, schemes of arrangement could be structured to avoid stamp duty, but such structures are now no longer available.

More on schemes

A scheme of arrangement differs from a contractual offer in that it is a statutory procedure controlled by the target and involving the court. It is not, therefore, appropriate for hostile bids as it involves an element of cooperation between the bidder and the target.

The process begins with an application to the court to convene a meeting of shareholders, or the relevant class of shareholders (see below), which will approve the scheme. Following such application, the scheme document will be sent to shareholders. The scheme document contains substantially the same information as an offer document and gives notice of the court-convened shareholder meeting (the 'court meeting'). It may also give notice of a general meeting which will be held immediately after the court meeting if shareholder approval is required for other matters, for example to make changes to the company's constitution to provide for compulsory transfer of shares issued following the scheme record time.

When convening the court meeting, it is essential that approval is sought from the correct class, or classes, of shareholders. If the shareholders' rights differ to the extent that it would be 'impossible for them to consult together with a view to their common interest' then they will constitute different classes and approval will be required of each class separately.

The scheme must be approved at the court meeting by shareholders (or shareholders of each relevant class) (a) holding at least 75% in value of shares voted and (b) being a simple majority in number of those voting.

Following the court meeting there will be a 'sanction hearing' at which the court will be asked to sanction the scheme. It will do so if (a) the statutory provisions, including as to notice and approval by the requisite majority, have been complied with, (b) the class was fairly represented by those attending the meeting and the statutory majority acted bona fide, and (c) the approval of the scheme is reasonable. While this is uncommon, it is open to dissentient shareholders or creditors to appear at the sanction hearing to oppose sanctioning the scheme.

If the court sanctions the scheme it will issue an order to that effect and the scheme will become effective when the order is delivered to Companies House.

Management deal

A crucial part of the structuring of any PTP is agreeing the form of the management deal with the financial sponsor, in particular the MBO team's shareholding in the bidding vehicle and the terms on which the members of the management team may roll over their investment in the target company into the bidding vehicle and any 'sweet equity' management incentive plan.

Rule 16.2 makes provisions for management incentivisation subject to certain requirements if they are discussed prior to completion of an offer. Where an offeror has entered into discussions as regards incentivisation arrangements:

- details must be disclosed in the public documents;
- the Rule 3 adviser must give a fair and reasonable opinion;
- where the value of the arrangements is significant and the nature of them is unusual, the Panel must consent and may require an independent shareholder vote; and
- where, as a result of the arrangements, members of management will become shareholders in the bidding group on a basis not available to other target shareholders, the arrangements must be approved by the independent shareholders.

The bidder may decide to postpone discussion of management incentives until after completion of the offer and avoid the above requirements and indeed this has become an increasing trend over the last few years. If it wishes to do so, then the only discussions the bidder should have with management relate to the availability of incentive arrangements and no numbers should be discussed, otherwise more detailed discussions could become subject to the above requirements. The bidder is required to confirm the nature of any discussions in the public documents.

Key documents

Whether the PTP is implemented by takeover offer or scheme, the following are the principal documents used:

Key Funding Agreements

- **Subscription agreement (if relevant)**
  This is the document under which the financial sponsor and, if relevant, the

management team agree to subscribe in cash for new shares in the bidding vehicle (or a parent undertaking of the bidding vehicle). The proceeds are used to part finance the cash consideration to be offered to target shareholders. The subscription obligation is conditional only upon all conditions to the PTP being satisfied or waived.

- **Share exchange agreement (if relevant)**
  This is the document under which the MBO team agrees to sell its shares in the target to the bidder where the consideration that they will receive is different from that to be offered to the other target shareholders (ie, normally shares in the bidding vehicle or one of its parent companies).

- **Investment (or shareholders') agreement (if relevant)**
  This is the agreement that regulates the ongoing arrangements relating to the financial sponsor's and MBO team's investment in the bidding vehicle (or one of its parent companies).

- **Banking documents**
  These documents commit the lending bank(s) to provide the acquisition finance, any refinancing facility for existing target debt and a working capital facility for the target group. Under Rule 24.8, there must be certainty that the financing for the cash consideration for the PTP will be available by the time the bidder makes a firm offer announcement under Rule 2.7. This has to be confirmed by the bidder's financial advisers in the press announcement of the offer and in the offer/scheme document itself. Therefore, between the time of such an announcement and completion of the PTP (often referred to as the 'certain funds period'), there must be very limited conditions outstanding or termination rights relating to the availability of the acquisition finance facility.

- **Equity commitment letters**
  These are letters in support of the cash confirmation statement described above, in which the parties providing equity finance to the bidder group irrevocably undertake (subject to conditions) to provide the agreed subscription amounts by an agreed date. If there is a subscription agreement, then equity commitment letters will not be needed.

Key Offer/Scheme Documents

- **Irrevocable undertakings: see above**

- **Announcement of firm intention to make the offer (Rule 2.7 announcement)**
  This is the formal public announcement that announces the terms and conditions of the PTP. Once this announcement is made, the bidder is compelled to proceed with the PTP, subject only to satisfaction of the relevant conditions that are specified in the announcement. These conditions will include an acceptance condition which, in the case of a takeover offer, is normally a condition that not less than 90% of the shares to which the offer relates are assented to the offer, although the bidder will usually reserve the right to reduce this percentage to 50.1% at its absolute discretion. As explained above, the acceptance condition for a scheme is not less than 75% by value and a majority in number of the target shareholders who vote on the scheme, voting in favour of the scheme and the court subsequently sanctioning the scheme.

- **Offer or scheme document**
  This document contains the actual offer for the target's shares. As well as containing all the required terms and conditions of the PTP, it must also

contain details of the bidding vehicle and its debt and equity backers and also certain information relating to the target company. If the PTP is recommended by the independent directors (which in practice is likely to be the case given there are very few hostile PTPs), this document will also include the formal recommendation of the PTP from the independent directors which must be supported by the opinion of the target's financial (or 'Rule 3') adviser.

The directors of the bidder must, together with certain executives from the financial sponsor (typically the investment committee), accept personal responsibility for the information relating to the bidder in this document (Rule 19.2 of the Code). The directors of the target (including any members of the MBO team) will be required to accept personal responsibility for the information relating to the target in this document. The independent directors of the target will also take personal responsibility for their recommendation of the PTP.

- **Cooperation or bid Conduct Agreement**
  Although Rule 21.2 of the Code prohibits most offer-related agreements, the bidder and the target may enter into a cooperation or 'bid conduct' agreement if the offer is to be implemented by way of a scheme of arrangement, containing arrangements setting out their obligations to cooperate to obtain regulatory clearances and other permitted covenants, including the bidder's obligation to cooperate with the implementation of the scheme, provisions with regard to invoking conditions, switching from a scheme to an offer and share scheme proposals. Although inducement fees from the target are prohibited, with limited exceptions, under Rule 21.2, the cooperation agreement can (albeit rarely) make provision for a reverse break fee from the bidder.

Cash confirmation

Where the consideration for the proposed offer is in cash or includes an element of cash (which is usually the case for a PTP), Rule 24.8 of the Code provides that the bidder's financial advisers (or another appropriate third party) must confirm in the offer/scheme document that the bidder has sufficient resources to satisfy full acceptance of the takeover offer.

The bidder's financial advisers will need to ensure that any portion of the purchase price to be funded by equity finance is backed up by enforceable subscription obligations or equity commitments. The equity subscribers will be required to undertake irrevocably to provide a minimum subscription amount. Such commitments must be subject only to the conditions of the offer/scheme being fulfilled. They will also need to be comfortable that any acquisition finance to be provided by the lending bank to fund the offer will be available on the offer becoming unconditional. They will therefore need to examine closely the rights in which the lending bank may have to withdraw the acquisition facilities and the conditions precedent which must first be satisfied before the lending bank is required to pay out money under the facilities.

It is common to provide in the banking documents that, if certain events occur prior to drawdown, the bank will be entitled to withdraw its finance. In order to enable the bidder's financial advisers to give the requisite confirmation in the offer/scheme document as required by Rule 24.8, these events are restricted to a limited number (primarily relating to the solvency of the bidder and matters which fall within the control of the bidder) during the so-called 'certain funds period'.

The certain funds period is normally defined as the period between the release of the press announcement announcing a firm intention to make the offer and the completion of the acquisition, subject to certain alternative triggers (such as lapse of the offer) and a long stop date.

Disclosure of financing arrangements

All offer documents must contain a description of how the offer is to be financed and the source of the finance.

With regard to debt facilities and other instruments entered into to finance the offer or refinance existing debt or facilities, the offer document must set out the principal terms of each facility. Copies of all the loan documents must also be made available on a website following a firm offer announcement (although the Panel will typically not require market flex arrangements to be on display until the offer document is published). Equity commitment letters will also need to be made available on the website.

Conditionality and MACs

Although the offer will be subject to conditions covering regulatory consents and material adverse changes ('MACs'), the Panel will only grant consent for the bidder to invoke such conditions where the circumstances that give rise to the right to invoke the condition are of material significance to the offeror in the context of the offer, subject to certain exceptions, including the acceptance condition (which requires notice to invoke, as set out below). In practice, consent will only be granted by the Panel in extreme circumstances. The Panel stated in its decision on WPP's bid for Tempus (and subsequently repeated), in which the adverse change in question arose as a result of the events of 9/11, that '… meeting this test requires an adverse change of very considerable significance striking at the heart of the purpose of the transaction in question.'

The Code also prevents a bidder from circumventing the material significance requirement by invoking the acceptance condition, which is not subject to this requirement. A bidder wishing to invoke the acceptance condition must serve an 'invocation notice', giving target shareholders 14 days in which to accept the offer before it lapses.

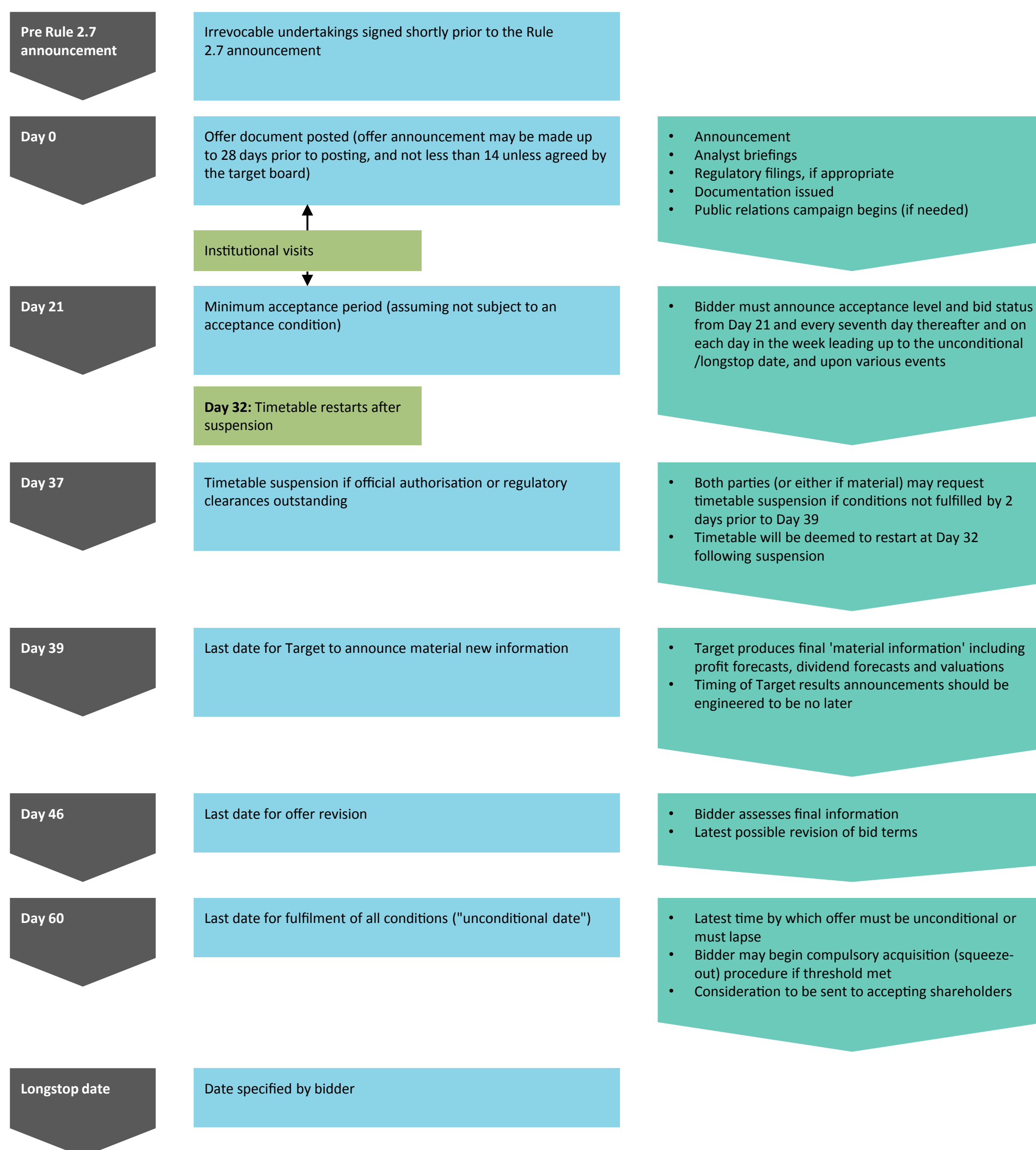
The question of MAC conditions arose on Brigadier's 2020 bid for Moss Bros in the context of the Covid-19 pandemic. Brigadier had announced a firm intention to make an offer on 12 March 2020, the day after the World Health Organisation declared the Covid-19 outbreak a pandemic. On 22 April 2020 Brigadier sought to invoke its MAC condition, and certain other conditions, in order to withdraw its offer. The Panel ruled that Brigadier had not established that the circumstances were of material significance in the context of its offer and that the conditions could not be invoked. Although not entirely surprising given the foreseeability of the circumstances at the time of the offer, this ruling demonstrates the high bar for invocation of MAC conditions.

In connection with the Code amendments which came into force in July 2021, the Panel amended its guidance on the invocation of conditions to include a number of additional factors which will be taken into account in deciding whether the 'material significance' test has been met. The guidance now states that the Panel will consider (a) whether the relevant condition was negotiated with the target; (b) whether it was expressly drawn to target shareholders' attention; (c) whether it was included to take account of specific circumstances; (d) foreseeability of the circumstances when the offer was announced; (e) the actions of the bidder; and (f) the views of the target's board.

PHASE 6 – OFFER IMPLEMENTATION

Figure 9: Timetable

Indicative cash offer timetable from posting



Notes:

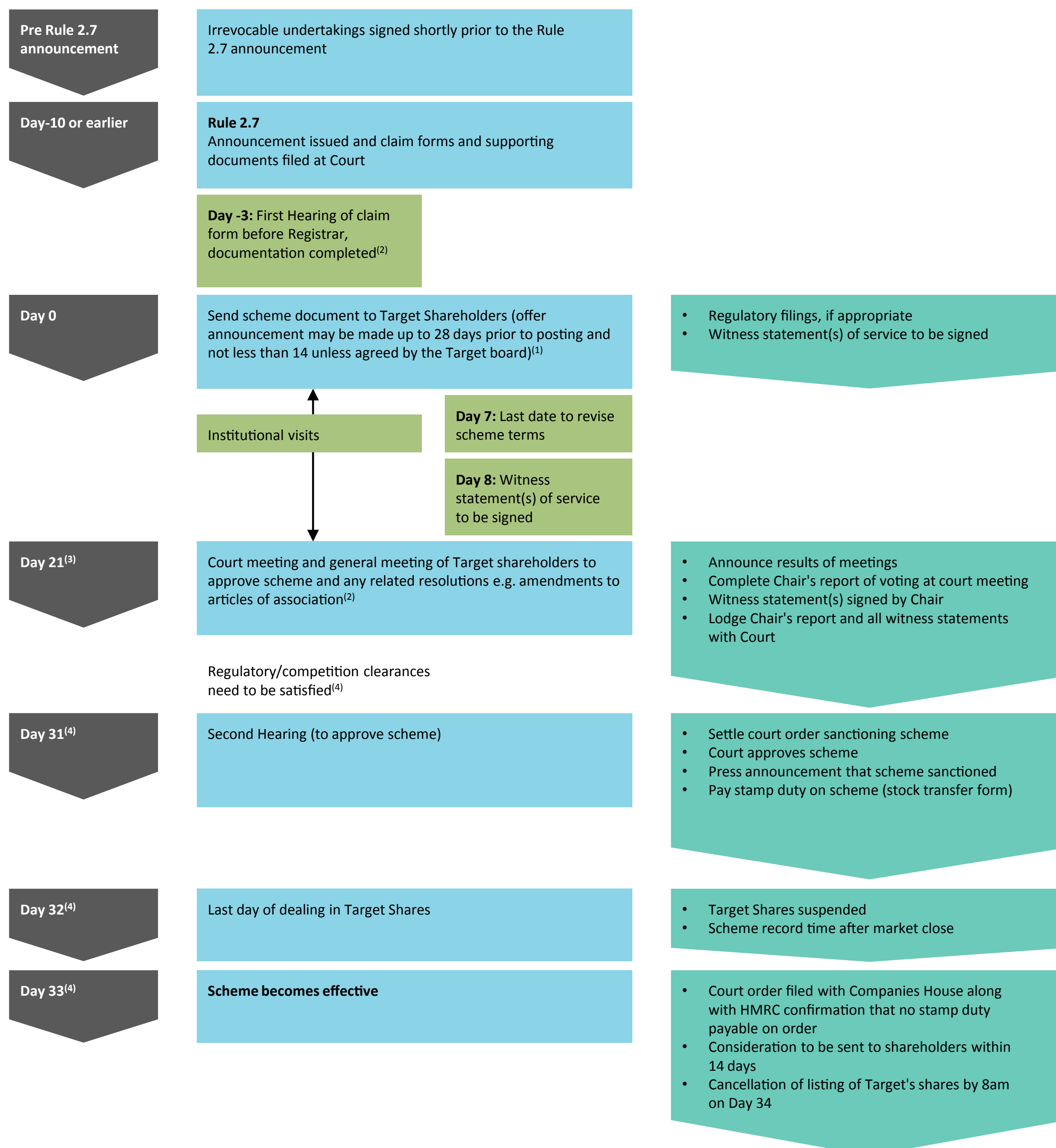
(1) This timetable assumes that there is no competing offer

(2) An offeror may bring forward the unconditional date by making an “acceleration statement”, in which case (a) it will be required to waive its regulatory conditions and (b) the requirements which are normally imposed on Days 39 and 53 will not be applied

(3) An offeror which wishes to invoke the acceptance condition prior to the unconditional date may serve an “acceptance condition invocation notice”

Figure 9 contd:

Indicative scheme timetable from posting



Notes:

(1) Scheme document to be posted within 28 days of rule 2.7 announcement (except with consent of Panel) and not less than 14 days following the 2.7 announcement unless Target board agrees.

(2) Actual dates will depend on availability of Court dates (which can be harder to arrange over the Christmas, Easter and summer recesses)

(3) This is the earliest that the court meeting may be held under the Code. This will depend upon the ability of the Company to give valid notice of the general meeting by this date.

(4) If there are regulatory conditions to be satisfied then Days 31 onwards will be deferred until satisfaction or waiver.

Completion and squeeze-out of minorities under a contractual offer

If a bidder receives sufficient acceptances under a contractual takeover offer from at least 90% of the shares to which the offer relates (excluding those held by the financial sponsor and, where they are rolling over all or some of their shareholding in the target, the MBO team prior to the offer document being sent to the target shareholders), it is entitled to invoke the statutory squeeze-out procedure set out in the Companies Act to compulsorily acquire the remaining minority shares.

To do this, the bidder must first send out notice to the non-assenting target shareholders within three months of the day after the last day on which the offer can be accepted. In practice, the bidder (and its lending banks) will want to invoke the procedure as soon as possible. Once the notice has gone out, the bidder has to wait six weeks before the remaining minority shares can be compulsorily acquired. During this period, it is possible for target shareholders to seek a court order preventing the bidder from being able to exercise these rights on the basis that the offer was not fair and proper. Such an order is unlikely to be granted unless the shareholders have not been treated equally.

At the end of the six-week period, the remaining shares in the target company are transferred to the bidder under the statutory provisions against payment by the bidder to the target company (on trust for the minority shareholders) of the consideration payable for the shares so acquired.

The squeeze-out procedure is not relevant on a takeover offer implemented by way of a scheme of arrangement as a scheme secures acquisition of 100% of the target shares as long as the appropriate approvals are obtained.

Re-registration as a private company

Normally, once the compulsory acquisition procedure has completed (in the case of a contractual takeover offer) or once the scheme has become effective, the bidder will re-register the target as a private limited company. This is important because unless the company is re-registered (ie, is no longer a public company) then the granting of security to the bidder's lending banks in respect of the acquisition finance facility granted to the bidder may constitute unlawful financial assistance by the target for the purchase of its own shares.

De-listing

Under the FCA's Listing Rules (which apply to those companies listed on the Official List) and the AIM Rules (which apply to those companies traded on AIM), not less than 20 business days' prior notice must be given of any intended cancellation of the company's listing and a circular sent to target company shareholders. However, this rule does not apply to schemes of arrangement. In relation to a contractual offer, if notice of the proposed cancellation is included in the offer document, no further circular is required and the 20-business-day period can start running from either the bidder receiving acceptances from shareholders holding 75% of the target's voting shares or the compulsory acquisition procedure being commenced. Where the bidder controls more than 50% of the voting rights in the target prior to announcing the bid, it must have acquired or agreed to acquire a majority of the shares held by independent shareholders before the 20-day period can begin.

Other considerations

Employee interests and representatives and right of reply

Both the bidder and the target must make the offer announcement available to their employee representatives or, if there are none, directly to their employees. The target must inform its employee representatives (or employees) and pension scheme trustees that they have a right to have a separate opinion appended to the target board circular (which on a PTP will usually be part of the offer document).

Where the target has employee share option schemes in place, the holders of options must receive an appropriate offer or proposal to ensure their interests are safeguarded (Rule 15 of the Code). This may include the right to exercise their options and accept the offer, to exchange the options for options in the bidder, or a cash payment for cancellation of the options.

Profit forecasts, quantified benefits statements

Profit forecasts and 'quantified financial benefits statements' published during an offer period by the target, or by a bidder which is offering equity consideration, and profit forecasts which are still current and published prior to the offer period, are subject to reporting requirements (Rule 28 of the Code). A 'quantified financial benefits statement' is any statement quantifying the financial benefits of the takeover offer if it is successful or if the offer is withdrawn or lapses.

If a profit forecast or quantified financial benefits statement is published by the target during the offer period, the document in which it is published must contain:

a. a report from its reporting accountants stating that it has been properly compiled and that the basis of accounting used is consistent with the company's accounting policies; and

b. a report from its financial adviser(s) stating that it has been prepared with due care and consideration.

Where such a forecast is made prior to the offer period, the forecast must be repeated in the offer or scheme document (or any earlier document during the offer period in which it is referred to) and accompanied by the required reports. If such a forecast is made prior to an approach, then the party making the forecast may either:

a. repeat the profit forecast and include a statement by the directors that it remains valid and confirmations by the directors that the profit forecast has been properly compiled on the basis of the assumptions stated and that the basis of accounting used is consistent with the company's accounting policies (the 'directors' confirmations'); or

b. include a statement by the directors that the profit forecast is no longer valid and an explanation of why that is the case; or

c. include a new profit forecast for the relevant period and reports from its reporting accountants and financial adviser(s) (as for a new offer made in the offer period).

The rules are less onerous for 'ordinary course' profit forecasts and forecasts for less than 15 months. The Panel may grant dispensations from the reporting requirements in respect of such forecasts. However, it will not normally do so where the relevant offer is a management buyout, given the potential for management teams to depress the forecast in order to achieve a lower offer price.

Asset valuations

The Code contains requirements for an independent valuer's opinion on any asset valuation given by the target or a bidder offering equity consideration

a. during the relevant offer period;

b. in the 12 months prior to the commencement of the offer period; or

c. more than 12 months prior to the commencement of the offer period, if attention is drawn to that valuation in the context of the offer.

Share buying

A very important tactic for consideration in relation to the execution of any PTP is whether the bidder should acquire shares in the target outside the takeover offer or scheme.

There are a number of points to be considered:

- Rule 4 of the Code prevents any person other than the bidder who has price sensitive information about the proposed offer from dealing in target securities at any time after an approach has been made.
- Once the bidder has commenced its due diligence on the target and has as a result obtained inside information relating to the target, it will not be permitted under the Market Abuse Regulation to purchase shares in the target until at least the announcement of a firm intention to make the PTP. The only real opportunity therefore to acquire shares in the target before public announcement is at the very beginning of the process. In practice, most potential bidders are unwilling to commit funds until there is more certainty that the PTP will go ahead.
- If the bidder (or other concert party members) acquire interests in shares in the target during the offer period or in the three month period prior to it starting, then the highest price paid by any of them for such interests will, under the Code, set the minimum price that must be offered to target shareholders if a PTP is subsequently announced. If during the bid process or in the 12 month period prior to that time, these persons acquire in aggregate interests in shares representing 10% or more of the target's shares, then the highest price paid by any of them for such interests during this 12 month period will set the minimum price that must be offered to target shareholders in cash (Rule 11).
- Under Rule 9, if a person (including a concert party member) acquires interests in shares in the target which takes the combined shareholding of it and its concert party members to 30% or more, then it will be required to make an all-cash bid for the target, where the only condition can be that it obtains acceptances of the bid which takes its combined shareholding to over 50% of the target company's shares.

- Where the PTP is to be implemented by way of a takeover offer, any shares in the target acquired by the bidder before the offer document has been received by target shareholders cannot count towards the 90% acceptance condition required to be satisfied before the statutory compulsory squeeze-out provisions can be implemented.
- Where the PTP is to be implemented by way of a scheme, any shares in the target acquired by the bidder at any time cannot be voted on the shareholder resolution required to approve the scheme.
- A bidder who deals in target shares for the purposes of stakebuilding when it has inside information relating to the acquisition, may benefit from the 'facilitation defence' to insider dealing. However, this defence will only apply to dealings in shares, and not to derivatives such as contracts for difference.

Formal sale processes

Where a target announces that it is seeking buyers by way of a formal sale process, the Panel will normally grant dispensations from:

- The obligation to identify each potential bidder; and
- The 28 day 'put up or shut up' provision so long as a bidder is participating in the process.

The Panel will also usually grant a dispensation from the prohibition on 'offer-related arrangements' so as to allow an inducement fee arrangement with a bidder who has participated in the sale process once a firm intention announcement has been made. The inducement fee must be de minimis (1% or less of the offer consideration) and must not be payable until an offer is declared unconditional.

Brexit

Brexit has had a very minor impact on takeovers and the Code, but it resulted in changes to the transactions to which the Code applies.

Prior to 31 December 2020, if a company was incorporated in an EAA member state (not in the UK) and listed in the UK, or was incorporated in the UK and listed in an EEA member state, then the Panel could share jurisdiction with the authority in that EEA state. Following the Brexit transition period the concept of 'shared jurisdiction' has been deleted from the Code. Therefore, an offer for a company incorporated in an EEA state but traded on a UK market is no longer subject to the Code. An offer for a UK company traded on an EEA market (and not a UK market) will not be subject to the Code unless the target has its central management and control in the UK. The Code will, however, apply in full to an offer for a company which has its registered office in the UK and whose securities are admitted to trading on a regulated market in a remaining EEA Member State (but not on a UK regulated market) if the company satisfies the residency test set out above.

Following the UK's exit from the EU and the end of the transition period, the wider effects of Brexit should be considered. For example, offers of securities, and communications with regard to securities are now subject to separate regimes in the UK and Europe. These are currently largely equivalent, but may diverge over time. Similarly, companies with shares admitted to trading in the EU and the UK are now subject to separate market abuse regimes.

CLOSING REMARKS

PTPs can present valuable opportunities for financial sponsors and management teams. However, these parties must be alive to the inherent execution risks, and prepared to commit to a deal and be ready with committed finance, at an early stage in the process.

Given the formality of the process, and the regulatory complexities, it is imperative that bidders have in place the proper legal and financial advice from the very beginning of the transaction.

About the authors

Joseph Katz
Partner
PwC

joseph.katz@pwc.com
+44 7710 034052

Joseph is a Partner in the PwC Healthcare M&A team, based in London. He has advised on a wide range of healthcare and other transactions, including many public offers, having previously been at Rothschild & Co. In 2012-2014 Joseph acted as Assistant Secretary to the Takeover Panel and oversaw a large number of transactions subject to the Takeover Code. Prior to his career in investment banking, he qualified as a lawyer with Slaughter and May.

Jonathan Raggett
Director
PwC

jonathan.raggett@pwc.com
+44 7702 678193

Jon is a Director in the PwC Corporate Finance team, based in London. He has a broad range of transaction experience, with a focus on public company and capital markets transactions. Jon has worked on many cross-border public takeover bids and mergers as well as a large number of private equity-backed public to private transactions. Jon is a Fellow of the ICAEW.

Chris Hale
Senior Consultant
Travers Smith

chris.hale@traverssmith.com
+44 2072 953 263

Chris is the firm's Chair Emeritus and is a senior consultant in the Private Equity & Financial Sponsors Group, which he founded in 1996. Chris was Senior Partner between 2013 and 2019, Head of Corporate from 2003 to 2013, and was made a partner in 1987. For most of his career Chris has specialised in UK and international M&A and buyout work acting for institutional investors and management teams on investments and divestments, as well as private equity-backed and large private companies on M&A and other corporate matters. He has worked on many take-privates including the UK's largest, that of Alliance Boots.

Spencer Summerfield
Head of Corporate
Travers Smith

spencer.summfield@traverssmith.com
+44 2072 953 229

Spencer is Head of Travers Smith's Corporate Group. He has a broad corporate practice but his principal area of work is UK and international corporate finance, including mergers, acquisitions and disposals, flotations and underwritings, corporate joint ventures and general corporate advice. His clients include a number of large quoted and private companies, as well as several financial sponsors. Spencer's recent public takeover experience includes advising Basalt Infrastructure Partners on its takeover of Manx Telecom, Aggregated Micro Holdings on its takeover by Fossa, and Macquarie on its takeover of Premier Technical Services Group.

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www.charteredaccountantsworldwide.com
www.globalaccountingalliance.com

ICAEW
Chartered Accountants' Hall
Moorgate Place
London
EC2R 6EA UK

T +44 (0)20 7920 8100
E generalenquiries@icaew.com
icaew.com

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The Corporate Finance Faculty is the ICAEW's centre of professional expertise in corporate finance. It contributes to policy development and responds to consultations by international organisations, governments, regulators and other professional bodies.

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T +44 (0)20 7920 8483
E cff@icaew.com

* Source: CAW, 2020 – Interbrand, Best Global Brands 2019

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