ICAEW
REPRESENTATION 71/23

REVIEW OF RULE 21 (RESTRICTIONS ON FRUSTRATING ACTION) AND OTHER MATTERS

Issued 25 July 2023

ICAEW welcomes the opportunity to comment on the *Review of Rule 21 (Restrictions on frustrating action) and other matters*, published by the Takeover Panel on 15 May 2023, a copy of which is available from this link.

For questions on this response please contact ICAEW Corporate Finance Faculty at CFF@icaew.com quoting ICAEW REP 71/23.

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ANSWERS TO SPECIFIC QUESTIONS

Q1 Should the new definition of "restricted action" be introduced in the new Rule 21.1(c) as proposed?

1. We agree that the new definition should be introduced as proposed.

Q2 Should issuing shares or convertible securities, granting options or awards over shares, or redeeming or buying back shares or convertible securities by the offeree company, other than in the ordinary course of business, in any amount be a restricted action, as proposed in the new Rules 21.1(c)(i) to (iii)?

2. Yes, issuing shares or convertible securities, granting options or awards over shares, or redeeming or buying back shares or convertible securities by the offeree company, other than in the ordinary course of business, in any amount should be a restricted action.

Q3 Should the current Note 5 on Rule 21.1 be amended as proposed with regard to employee incentivisation arrangements?

3. We broadly agree that the current Note 5 on Rule 21.1 should be amended as proposed, subject to a comment regarding new Note 1(a)(ii) on Rule 21.1.
4. Specifically, it would be helpful if the Code Committee could elaborate on the level of detail it would expect to have been publicly announced about the proposed practice under a new share incentive scheme as well as on the format of that information.

Q4 Should a redemption or purchase of its own shares by the offeree company in line with defined limits announced or established before the relevant period normally be in the ordinary course of the offeree company's business, as proposed in the new Note 2 on Rule 21.1?

5. Yes, a redemption or purchase of its own shares by the offeree company in line with defined limits announced or established before the relevant period should normally be in the ordinary course of the offeree company's business.

Q5 Should the Panel be able to have regard to additional or alternative indicators of materiality that it considers appropriate either in the context of the relevant industry or in order to take into account the particular circumstances of the offeree company when determining whether a disposal or acquisition of assets is of a material amount, as set out in the proposed new Note 3(c) on Rule 21.1?

6. We agree that the Panel should be able to have regard to additional or alternative indicators of materiality that it considers appropriate when determining whether a disposal or acquisition of assets is of a material amount.
7. We would like to propose two drafting suggestions to new Note 3 on Rule 21.1. In the first instance, we think an addition to the definition of "assets" in new Note 3(a), shown below in bold, would be helpful:

   'For these purposes:

   When calculating the value of the assets of the target company, "assets" will normally mean total assets less current liabilities (other than short-term indebtedness)'
8. Second, we think that part of the relevant consideration in new Note 3(c) should be '**or the type of asset in question**'.

Q6 Should only disposals and acquisitions that are outside the ordinary course of the offeree company's business be included in the calculation when determining if the relevant assets are, in aggregate, of a material amount, as set out in the proposed new Note 3(e) on Rule 21.1?

9. Yes, we agree with the proposed new Note 3(e) on Rule 21.1.

Q7 Do you have any comments on the matters that the Executive will consider when determining whether a disposal or acquisition of assets is in the ordinary course of the offeree company's business, as set out in the draft new Practice Statement No 34?

10. Draft new Practice Statement No 34, paragraph 2.3(b), specifies that the Executive will consider, inter alia, the terms of a proposed acquisition or disposal when determining whether the transaction is in the ordinary course of the offeree company's business, and whether the terms are in line with normal practice. Would the basis of valuation be included in the terms that the Executive is likely to consider?
11. According to paragraph 2.6(b) of the draft Practice Statement, the Executive's consent will be required before an investment trust company can sell an abnormal proportion of its investment portfolio. If the sale of that "abnormal" proportion was in line with the company's investment policy, does the Panel agree that such a disposal should not be restricted?

Q8 Should the Panel normally consider an inducement fee arrangement proposed to be entered into by the offeree company to be a material contract outside the ordinary course of the offeree company's business if: (a) before a firm offer is announced, the fee is more than 1% of the market value of the equity share capital of the offeree company (as determined in accordance with the new Note 3 on Rule 21.1); or (b) following the announcement of a firm offer, the fee is more than 1% of the value of the offeree company by reference to the offer price (as is currently the case)?

12. Yes, an inducement fee arrangement proposed to be entered into by the offeree company to be a material contract should be considered to be outside the ordinary course of the offeree company's business in the circumstances and at the levels described.

Q9 Do you have any comments on the matters that the Executive will consider when determining whether: (a) an individual contract; or (b) a particular type of contract, is in the ordinary course of the offeree company's business, as set out in the draft new Practice Statement No 34?

13. Has the Code Committee considered whether the guidance provided in draft new Practice Statement No 34, paragraph 3, regarding "material contracts" and the "ordinary course of business" will (and should) in effect be used as guidance for the purposes of Rules 24.3(a)(vii) and 25.7(a), which relate to the public disclosure of the summaries of material contracts (and, indeed, other rules also refer to material contracts – eg Rule 26.3(d))?
14. Regarding draft new Practice Statement No 34, paragraph 3.3(c), the description of a contract as being of "particular" importance is a subjective assessment and it would be helpful if the Practice Statement gave examples of metrics or data that may be used in the assessment.
15. In relation to paragraph 3.3(d), can more detail be provided about the type of "terms" that the Executive will assess?
16. In relation to draft new Practice Statement No 34, paragraph 4, while we understand that the Panel cannot cover all example contracts, we think it would be helpful to highlight employment recruitment and severance agreements with board members/senior management here given the prevalence of these contracts.

Q10 Should the Panel be consulted to determine whether entering into offer-related employee retention arrangements that relate to a period that is prior to the end of the offer period would be a restricted action, as proposed in the new Note 1(c) on Rule 21.1?

17. Yes, the Panel should be consulted as proposed.

Q11 Do you have any comments on the circumstances in which the Executive may consider entering into offer-related employee retention arrangements to be a restricted action, as set out in the draft new Practice Statement No 34?

18. The circumstances in which offer-related employee retention arrangements may be considered to be a restricted action, as set out in draft new Practice Statement No 34, seem in line with current practice. However, it would be helpful to understand how the Code Committee considers practitioners should distinguish between offer-related employee retention arrangements under Note 1(c) on Rule 21.1 (and paragraph 5 of the draft new Practice Statement No 34) and Note 4 on Rule 21.1.
19. The term "senior management", which is used in Note 1(c) on Rule 21.1 and in draft new Practice Statement No 34, is not defined in the Code or in the PCP (ie in paragraph 2.90). Can the Code Committee explain its thinking on who would be caught under "senior management", and does it expect that the Executive will require information on broader organisational structure and bands? In the context of listed companies, the definition of "Executive Management" in Listing Rule Appendix 1 could perhaps be relevant,
20. Moreover, would the Code Committee confirm whether arrangements to reflect a change in an employee's role (eg an expansion in their role, whether in relation to responsibilities and/or time commitment) may be considered relevant to the analysis as to whether a proposed arrangement is determined to be a restricted action? Other relevant factors for consideration might include historical practice, including in relation to other employees in the same or similar role, or in relation to the particular employee in question.

Q12 Should: (a) the current Note 3 on Rule 21.1 (Interim dividends); and (b) the current Note 6 on Rule 21.1 (Pension schemes), be deleted?

21. We agree that current Note 3 on Rule 21.1 should be deleted.
22. We believe that current Note 6 on Rule 21.1 should be retained. It provides helpful context for situations where an arrangement between an offeree company and the trustees of the company's pension scheme could be restricted by new Rule 21.1(c)(v), even though such situations are only expected to occur exceptionally.

Q13 Should the restrictions in Rule 21.1(a) apply during the "relevant period", as specified in the proposed new Rule 21.1(b)?

23. Yes, the restrictions should apply during the "relevant period", as specified in proposed new Rule 21.1(b).

Q14 Where no offer period has begun, should the relevant period end at 5.00 pm on the seventh calendar day following the date on which the latest approach is unequivocally rejected?

24. We agree that, where no offer period has begun, the relevant period should end as proposed.

Q15 Should the new Note 7 on Rule 21.1 be introduced as proposed to clarify the application of the relevant period where there is more than one offeror?

25. We agree that new Note 7 on Rule 21.1 should be introduced as proposed to clarify the application of the relevant period where there is more than one offeror.

Q16 Should the new Note 9(a) on Rule 21.1 be introduced to provide that, where the offeree board is seeking a potential offeror for the company, the relevant period for a potential offeror will not normally begin until that potential offeror makes a proposal with indicative offer terms?

26. Yes, the new Note 9(a) on Rule 21.1 should be introduced as proposed.

Q17 Should the new Note 9(b) on Rule 21.1 be introduced to provide that, where a purchaser is being sought for interests in shares carrying in aggregate 30% or more of the voting rights of a company, the Panel should be consulted to determine when the relevant period will begin?

27. Yes, the new Note 9(b) on Rule 21.1 should be introduced with clarification of the party that will be responsible for consulting the Panel.
28. Paragraph 3.40 in the PCP could imply that Rule 21.2 will not apply if the offeree board is not involved in the sale of the controlling shareholder's interest. We think there is a need for clarification in draft new Practice Statement 34 on the significance that board awareness or knowledge of a sale may have when determining the extent of the board's involvement. This will be relevant in situations such as where the large selling shareholder has a board representative, and that board member has disclosed the intended sale to the Chair, as part of conflicts management or otherwise.

Q18 Should presumption (7) of the definition of "acting in concert" be amended to provide that the directors of a company that is subject to an offer or a possible offer (together with their close relatives and the related trusts of any of them) are presumed to be acting in concert with each other from the beginning of the relevant period or, where the proposed new Note 9 on Rule 21.1 applies, the beginning of the offer period?

29. Yes, presumption (7) of the definition of "acting in concert" should be amended as proposed.

Q19 Should the new Note 8 on Rule 21.1 be introduced as proposed to provide that where an offer or possible offer is a reverse takeover, Rule 21.1 will also apply to the board of the offeror as if the offeror were an offeree company and vice versa?

30. Yes, new Note 8 on Rule 21.1 should be introduced as proposed.

Q20 Should: (a) the Panel consent to the restrictions in Rule 21.1(a) not being applied where an offeree board seeks to sanction a scheme of arrangement in a competitive situation, other than in exceptional circumstances; and (b) Note 10 on Rule 21.1 be introduced as proposed?

31. We have some concerns with the Panel being restricted from intervening except in "exceptional" circumstances. Some (but not all) of our members felt that the protections described in paragraph 5.6 of the PCP do not suffice where shareholders' implicit consent was not based on disclosures about a competing bidder and that the Panel should retain the ability to require an additional shareholder vote under Rule 21.1(a) in order for the offeree board to seek to sanction the scheme in a competitive situation.
32. Prima facie Rule 21.1(a) is applied, and we consider that the Panel should retain more flexibility to intervene.

Q21 Do you have any comments on the Executive's guidance as to how it would normally interpret "exceptional circumstances" for the purpose of the new Note 10 on Rule 21.1, as set out in the draft new Practice Statement No 34?

33. Please see answer to Q20.

Q22 Should: (a) an offeror be permitted to extend a mini-long-stop date with the consent of the Panel in a competitive situation; and (b) Sections 3(b) and 5 of Appendix 7 be amended as proposed?

34. We agree with the proposed amendments.

Q23 Should the restriction on general enquiries in Note 1 on Rule 21.3 be deleted?

35. We agree that the restriction should be deleted.

Q24 Should Rule 21.3 be amended to require the offeree board to provide promptly to the requesting offeror or bona fide potential offeror both: (a) the information that has been provided to another firm or potential offeror at the time of the request; and (b) any further information that it provides to the other firm or potential offeror in the seven days following the request?

36. We agree with the proposal.

Q25 Should Rule 21.4 in relation to management buy-outs be amended so as to require the offeror or potential offeror on request to provide to the independent directors of the offeree company or its advisers any information that it has provided, or subsequently provides, to external providers of finance?

37. We agree that Rule 21.4 should be amended as proposed.

Q26 Should the passing of information under Rule 21.3(a) be permitted to be subject to a condition that the potential offeror must seek the offeree company's consent before sharing its information with a potential finance provider, provided that such consent cannot be unreasonably withheld?

38. We have some concerns that target boards could use the subjectivity of "unreasonably withheld" as a defensive device in the context of a hostile offer. Some further guidance would be helpful to explain when an offeree might be deemed to be acting reasonably or unreasonably. An example might be that consent will be treated as unreasonably withheld if the potential offeror agrees to approach no more than a certain number of potential finance providers.

Q27 Should the current Note 5 on Rule 21.3 be amended to require an offeree board which commenced discussions in relation to a sale of all or substantially all of the offeree company's assets before the beginning of the "relevant period" (as defined in the proposed new Rule 21.1(b)), on request, to provide an offeror or bona fide potential offeror with the information it passes to the potential asset purchaser after the beginning of the relevant period?

39. We agree with this proposal.