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Changes to Application of UK Takeover Code

The UK's Panel on Takeovers and Mergers (the Panel) has published an amendment to the applicability of the UK's Takeover Code (the Code) that will particularly affect certain companies whose securities are admitted to trading on AIM or the ISDX Growth Market. It will be important for affected companies to understand the change and the significant implications that will result for them and their shareholders.

Background

The Code applies to companies with their registered office in the UK, the Channel Islands or the Isle of Man (the Applicable Territory) whose securities are admitted to trading on a regulated market in the UK (i.e. the Main Market of the London Stock Exchange or the ISDX Main Board), or any stock exchange in the Channel Islands or the Isle of Man. The Code regulates the procedure for the acquisition of shares in such companies including the following:

- the procedure for making an offer to buy such a company;
- the circumstances in which a party may be required to make an offer to buy such a company;
- certain required terms of any offer;
- the response required from, and the defensive steps that may be taken by, the target's board of directors; and
- the various time periods in which each of the above may, or must, occur.

The Code also applies to companies with their registered office in the Applicable Territory whose securities are admitted to trading on AIM or the ISDX Growth Market but only if their place of central management and control is within the Applicable Territory. Certain companies admitted to, for example, AIM have been structured specifically to avoid the application of the Code by ensuring that their place of central management and control is outside the Applicable Territory.

Changes to the Code's Applicability

Amongst other changes to the Code, with effect from 30 September 2013, the Code will apply to all companies with their registered office in the Applicable Territory whose securities are admitted to trading on AIM or the ISDX Growth Market irrespective of their place of central management and control. Therefore, companies whose place of central management and control is outside the Applicable Territory and who were not previously subject to the provisions of the Code will become subject to its provisions from 30 September 2013.

As is currently the case, companies with their registered office in the Applicable Territory but whose securities are admitted solely to trading on an overseas market will not be subject to the Code. The place of central management and control will still be relevant to determining the application of the Code to certain companies with their registered office in the Applicable Territory (such as public companies whose securities are not admitted to trading on a public market).

Considerations for Affected Companies

There are a number of practical considerations for affected companies and their shareholders that arise from these changes to the Code.

Conflicts with Articles

Many affected companies to which the Code did not apply previously have incorporated certain provisions of the Code into their articles, commonly those requiring a mandatory offer to be made for all of the company's shares by any shareholder acquiring over 30% of its share capital. The company's board will usually have a discretion to apply these provisions (in other words, act in the capacity of the Panel). It has been noted by many commentators that the relevant provisions of such companies' articles may now conflict with the Code provisions, with the Panel itself noting in its Response Statement (RS 2012/3):

> [T]he Code Committee understands that the application of such provisions will usually be subject to the discretion of the company's directors. Where this is the case, the Code Committee does not believe that their removal would be an urgent matter. Where the application of the provisions is not subject to the directors' discretion,…an implementation date of 30 September 2013 should provide sufficient opportunity for the required shareholder approvals to be obtained so as to avoid any risk of overlapping regimes arising.

Unfortunately, this does not clarify the position for those companies whose shareholders may not wish to pass a resolution to amend their articles.

Where conflicts do arise, directors will no longer have the power to enforce the relevant provisions of the articles as they see fit. The Code is given statutory effect, in the UK by the Companies Act 2006, and compliance with its provisions as enforced by the Panel is mandatory at all times. Directors are likely to have to disregard any conflicting provisions in the company's articles, as to enforce them in deference to the requirements of the Code could constitute a breach of the directors' duties to the company. Affected companies are advised to review their existing articles of association before 30 September 2013 and remove any provisions that may conflict with the Code.

Acquisitions of Further Securities

Rule 9 of the Code requires any person who acquires securities that carry 30% or more of the voting rights of a company, or who holds between 30% and 50% of the voting rights of a company and acquires any further voting rights, to make an offer for the entire issued share capital of that company. The Code sets out the timetable and certain specified terms of the offer (such as the minimum price to be offered for the securities). Shareholders in AIM or ISDX Growth Market listed companies that are now, but were not previously, subject to the Code must be aware of this requirement as well as any other provision of the Code that may impact on their dealings in the company's securities.

Any acquisitions of further securities currently contemplated by shareholders in such companies, or that are in progress, that would trigger the requirement for a mandatory offer should be completed before 30 September 2013. After 30 September 2013, shareholders must not acquire any further securities that take them over the 30% threshold, and shareholders who hold between 30% and 50% of a company's voting rights must not acquire any further voting rights, without being prepared to make an offer for all of the company's shares.

Concert Parties

When calculating a shareholder's percentage holding of a company's voting rights there must be included in the calculation any voting rights held by any persons who are acting 'in concert' with the relevant shareholder. Persons are acting 'in concert' where, pursuant to an agreement or understanding (whether formal or informal) they co-operate to obtain or consolidate control (i.e. 30% of the voting rights) of a company, or to frustrate an offer for the company. Certain parties (e.g. group companies, directors and their close relatives and company pension schemes) are deemed to be acting 'in concert' with a company unless the contrary can be shown.

Case Study

On 1 February 2013 Direct Finance LLC (the Bidder) published its offer to shareholders for the acquisition of the entire issued share capital of RGI International Ltd (RGI), a company incorporated in Guernsey whose shares were admitted to trading on the AIM market. RGI had been structured in such a way so as to ensure that its place of central management and control was outside the Applicable Territory, and as a result the Code did not directly apply to the acquisition of RGI's shares.

However, RGI's articles of association included provisions that incorporated by reference certain provisions of the Code, specifically provisions that prohibited any person from acquiring over 30% of RGI's voting shares unless the board had consented to the acquisition or the procedures for making a mandatory offer for the entire issued share capital of a company as set out in the Code (Rule 9) had first been followed. RGI's board was given the power to interpret the provisions of the Code as applied by its articles and any references to the Panel in the relevant Code provisions were to be interpreted as a reference to RGI's board.

Prior to making its offer the Bidder, along with its concert parties, had acquired over 30% of RGI's shares. As a result, in order for the Bidder to acquire further RGI shares, and for the shares held by the Bidder in excess of the 30% threshold to not be disenfranchised, it was necessary for the Bidder to make an offer for RGI's entire issued share capital. In doing so the Bidder was required to follow those provisions of the Code that governed the making of mandatory offers and to deal with RGI's board as the enforcer of those provisions.

If the same acquisition were to take place after 30 September 2013, then it would be subject to the full provisions of the Code irrespective of RGI's place of central management and control. The application of the Code would be overseen by the Panel. The provisions in RGI's articles that incorporate certain provisions of the Code by reference are applicable at the RGI board's discretion, and the board could not enforce any provisions of the articles that conflicted with those of the Code.

The authors of this article were part of a team of lawyers who advised the Bidder on its successful acquisition of RGI prior to joining Vedder Price LLP.

Shareholders in AIM or ISDX Growth Market listed companies that are now, but were not previously, subject to the Code must be aware of this requirement and must establish urgently the identities and percentage shareholdings of any other shareholders with whom they may be deemed to be acting 'in concert'. An acquisition of securities by a shareholder could trigger the requirement that a mandatory offer for all of the company's shares be made, notwithstanding that the shareholder's individual percentage of the voting shares does not exceed the above thresholds.

Convertible Securities

It is possible that shareholders in a company affected by the Code amendments could hold convertible securities, warrants or options to subscribe for new shares. The exercise of such conversion or subscription rights after 30 September 2013 could trigger an obligation to make a mandatory offer (under Rule 9 of the Code) if, as a result of the exercise, the shareholder's percentage of voting rights exceeds the 30% threshold or where the shareholder already holds between 30% and 50% of the company's voting rights.

Where this is the case, the Panel is likely, on the exercise of those rights, to grant a dispensation from the requirement to make a mandatory offer under Rule 9 provided that:

- the exercise of the relevant rights without requiring that a mandatory offer be made was approved by the company's shareholders at the time of the issue of the securities, or is subsequently approved at the time of exercise of the rights, or
- the shareholder undertakes to reduce the number of securities carrying voting rights in which it is interested to below the 30% threshold within a reasonable time (and agrees to certain restrictions on its voting rights pending such reduction).

Withdrawal from the Market

It may be that affected AIM or ISDX Growth Market listed companies and their shareholders do not wish to be subject to the requirements of the Code. In this case it would be necessary for the company to cancel its admission to the relevant market. Generally, this would require the consent of not less than 75% of the votes cast by a company's shareholders at a general meeting.

Conclusion

Companies with their registered office in the Applicable Territory whose securities are admitted to trading on AIM or the ISDX Growth Market who were not previously subject to the provision of the Code must now consider the impact that the Code may have on their corporate structure and the attractiveness of their listing. Such companies should review their constitutional documents in light of the Code provisions to remove any potential conflicts or uncertainties. Shareholders in such companies must be aware of the impact that the Code may have on their capacity to acquire further shares in the company without making a mandatory offer for its entire share capital.

The corporate team at Vedder Price LLP has significant experience in advising companies listed on UK markets, including AIM and the ISDX Growth Market, and their shareholders on their corporate structures and continuing obligations to the market. In particular, the team has recently advised on stake-building exercises leading to mandatory offers for the entire issued share capital of such companies, including the matter highlighted in the case study, in compliance with the provisions of the Code.

For More Information

Richard L. Thomas, *Partner*
Tel: +44 (0)20 3667 2930
Mobile: +44 (0)77 1517 3334
rlthomas@vedderprice.com

Sam Tyfield, *Partner*
Tel: +44 (0)20 3667 2940
Mobile: +44 (0)78 8789 3137
styfield@vedderprice.com

Jonathan Edgelow, *Associate*
Tel: +44 (0)20 3667 2925
jedgelow@vedderprice.com

Lydia Sadler, *Associate*
Tel: +44 (0)20 3667 2926
lsadler@vedderprice.com

Chicago
222 North LaSalle Street
Chicago, IL 60601
T: +1 (312) 609 7500
F: +1 (312) 609 5005

New York
1633 Broadway, 47th Floor
New York, NY 10019
T: +1 (212) 407 7700
F: +1 (212) 407 7799

Washington, DC
1401 I Street NW, Suite 1100
Washington, DC 20005
T: +1 (202) 312 3320
F: +1 (202) 312 3322

London
4 Coleman Street
London EC2R 5AR
T: +44 (0)20 3667 2900
F: +44 (0)20 3667 2901

San Francisco
275 Battery Street, Suite 2464
San Francisco, CA 94111
T: +1 (415) 749 9500
F: +1 (415) 749 9502