

KEY FACTS COMPANY LAW



4th edition

Ann Ridley

 **HODDER**
EDUCATION

Takeovers and mergers

The regulatory framework

Companies Act 2006 Part 28 gives statutory authority to:

- The Takeover Panel
- The Code on Takeovers and Mergers

Directors' duties in a takeover

- General duties owed to company: ss 171–177
- Duty to shareholders to give advice and information in good faith
- General principle 3, Code on Takeovers and Mergers

TAKEOVERS AND MERGERS

Arrangements and reconstructions

- Part 26 Companies Act 2006 – compromise or arrangement
- ss 110–111 Insolvency Act 1986 – amalgamation

Part 28 of the Companies Act 2006, which deals with takeovers, gives statutory authority to the Takeover Panel and introduces a number of complex new provisions. The first part of the chapter focuses on the role of the Takeover Panel and the City Code on Takeovers and Mergers. Section 15.6 considers compromises and arrangements (Part 26 CA 2006) and reconstructions (ss 110–111 IA 1986).

15.1 Introduction

1. A takeover is usually understood to mean the process by which one company gains control of another.
2. This is usually achieved by the purchase by the offeror company of shares in the offeree company.
3. Rather than receiving payment in cash, shareholders, who must agree to the purchase, will frequently acquire shares in the offeror company.
4. In private companies a share sale agreement is usually made between the offeror company and shareholders in the offeree company.
5. Private companies often have a provision in the articles of association allowing directors to refuse to register a transfer of shares, so that a takeover will not be possible without the authority and consent of the directors.
6. Public companies can offer shares to the public and may be listed on the Stock Exchange. They often have large and dispersed shareholdings.
7. The usual procedure is for the offeror company to send a circular to the shareholders in the offeree (or target) company making an offer to buy their shares.
8. The directors of the offeree company must then take professional advice and make a recommendation to the shareholders whether or not they should accept the offer.
9. The terms ‘merger’ or ‘acquisition’ are often used where the undertaking, property and liabilities of two or more companies are transferred to another company. This may be one of the original companies or it may be a new company. All or substantially all of the shareholders of the original companies become shareholders in the new company.

15.2 Part 28 Companies Act 2006

15.2.1 Background

1. Following a number of scandals concerning takeovers and mergers, the Code on Takeovers and Mergers was published in 1967, and in 1968 a panel was established, made up of people with experience of the City and its institutions.
2. Until May 2006 the Takeover Panel had no statutory authority and no legal powers of enforcement. It was a self-regulatory body, responsible for the regulation of takeovers of public companies in the United Kingdom within the framework of the self-regulatory rules contained in the City Code on Takeovers and Mergers.
3. In May 2006 the Takeover Directive (Interim Implementation) Regulations 2006, SI 2006/1183 came into force. This implemented the Takeover Directive (2004/25/EC) which set minimum standards on the regulation of takeovers of companies whose shares are traded on a regulated market.
4. Under the Directive member states are required to designate an authority to supervise takeover bids in accordance with rules made under the Directive. While the designated authority may be a non-statutory body, it must be recognised by national law. The regulations provided a statutory foundation for the work of the Takeover Panel.
5. The Takeover Directive required implementation by 20 May 2006 and the Takeover Directive (Interim Implementation) Regulations was a 'stopgap' measure to comply with EU law until the relevant sections of the Companies Act 2006 (CA 2006) were brought into force. Part 28 of the Act, which implements the Directive, was brought into force on 6 April 2007 and the Regulations were repealed.
6. CA 2006 provides a statutory foundation for the work of the Takeover Panel, providing a legislative framework and bringing to an end a long period of self-regulation.
7. Section 942 of the CA 2006 provides that the functions of the Panel on Takeovers and Mergers are conferred under Part 28 Chapter 1 of the Act.
8. The Act gives the Panel authority to make rules to give effect to the Takeover Directive (s 943), to give rulings on interpretation, application or effect of the rules (s 945), to impose sanctions on a person who has

acted in breach of the rules or failed to comply with a direction (s 952).

9. Until 20 May 2006, the Code did not have the force of law but worked on the premise that 'those who seek to take advantage of the facilities of the securities markets in the UK should conduct themselves in matters relating to takeovers in accordance with best business standards and so according to the Code'.
10. Section 955 CA 2006 now provides that the Panel may seek enforcement by the courts.
11. Section 953 provides for a new offence of failing to comply with the Takeover Directive in respect of certain documents issued in the course of a takeover.

15.3 The Takeover Panel

15.3.1 Composition and functions of the Panel

1. The panel is composed of:
 - the Chairman and Deputy Chairman, appointed by the Bank of England;
 - members who are representatives of leading City institutions.
2. It has the following functions now conferred by virtue of Part 28 CA 2006:
 - (a) Legislative – it drafts the provisions of the Code and makes amendments. This function is undertaken by the Code Committee.
 - (b) Interpretive – it interprets the Code as required in relation to particular cases and circumstances.
 - (c) Monitoring/investigative – it establishes whether there has been a breach of the Code.
 - (d) Enforcement – it ensures compliance with the Code:
 - if a breach is suspected, the company concerned is invited to appear before the Panel Executive;
 - if it is shown that a breach has occurred the Panel may issue either a private or a public reprimand, or the company may be reported to another United Kingdom or overseas authority or professional body, for example the Stock Exchange or the Financial Services Authority, which may take disciplinary action;
 - the Panel can also publish a statement to the effect that the offender is someone who, in the opinion of the Hearing

Committee, is not likely to comply with the code, which may result in members of certain professional bodies being required not to act for that person in certain transactions;

- s 954 now provides that the Panel can order compensation to be paid in certain circumstances;
- s 955 provides that on application by the Panel, a court may make whatever order it thinks fit if it is satisfied that there is a reasonable likelihood that a rule will be contravened or that a person has contravened a rule or disclosure requirement;
- decisions of the Panel may be reviewed by the Hearings Committee: s 951;
- the consequences of failure to comply with the rules governing bid documentation now also include criminal liability: s 953.

15.3.2 Judicial Review

1. It has been held that the Panel is subject to judicial review (*R v Panel on Takeovers and Mergers, ex parte Datafin* (1987); *R v Panel on Takeovers and Mergers, ex parte Guinness plc* (1990)). This is not affected by Part 28 CA 2006.
2. The courts have recognised that the Panel is required to make decisions quickly and with authority and may give a ruling for future guidance rather than reverse a past decision.

15.4 The Code on Takeovers and Mergers

1. Following implementation of the Takeover Directive and CA 2006, the rules set out in the Code now have a statutory basis. The eighth edition of the Code was published on 20 May 2006 and was amended on 6 April 2007 to reflect its statutory status. It is a lengthy document, containing six General Principles and a number of detailed Rules.
2. The main objectives of the Code are:
 - to ensure fair and equal treatment of all shareholders in relation to takeovers;
 - to provide an orderly framework within which takeovers are conducted.
3. The Code is not concerned with:
 - the financial or commercial advantages or disadvantages of a takeover. These are matters for the company and its shareholders;

- issues such as competition policy, which are the responsibility of government and are dealt with by separate legislation.

15.4.1 Principles underpinning the code

The general principles are statements of acceptable standards of commercial behaviour and reflect the principles set out in Art 3 of the Directive. They are:

1. All holders of the securities of an offeree company of the same class must be afforded equivalent treatment; moreover if a person acquires control of a company, the other holders of securities must be protected.
2. The holders of securities of an offeree company must have sufficient time and information to enable them to reach a properly informed decision on the bid; where it advises the holders of securities, the board of the offeree company must give its views on the effects of implementation of the bid on employment, conditions of employment and the locations of the company's places of business.
3. The board of an offeree company must act in the interests of the company as a whole and must not deny the holders of securities the opportunity to decide on the merits of the bid.
4. False markets must not be created in the securities of the offeree company, of the offeror company or of any company concerned by the bid in such a way that the rise or fall of the prices of the securities becomes artificial and the normal functioning of the markets is distorted.
5. An offeror must announce a bid only after ensuring that he or she can fulfil in full any cash consideration, if such is offered, and after taking all reasonable measures to secure the implementation of any other type of consideration.
6. An offeree company must not be hindered in the conduct of its affairs for longer than is reasonable by a bid for its securities.

15.5 Directors' duties in a takeover

1. Directors owe fiduciary duties to the company, not to individual shareholders, and must not use their powers for an improper purpose (s 171 CA 2006; *Hogg v Cramphorn* (1967)).
2. A takeover situation may lead to certain conflicts of interest and it has been held that directors owe a duty to shareholders to ensure that any

information and advice is given in good faith and is not misleading (*Dawson International plc v Coats Patons plc* (1988)).

3. In addition, note General Principle 3 (see section 15.4.1) which requires directors of the offeree company to act in the interests of the company as a whole.

15.6 Arrangements and reconstructions

15.6.1 Part 26 CA 2006

1. A compromise or arrangement may be made under the Companies Act, Part 26. This allows the rights of both creditors and members to be varied.
2. Under s 896(1) an application may be made to the court by the company or any member or creditor of the company, or, if the company is being wound up or in administration, by the liquidator or administrator. The court may order a meeting of members or class of member, creditors or class of creditor to consider the proposal.
3. Section 897 requires that statements containing certain specified information must be circulated to creditors or members entitled to attend.
4. An arrangement will be binding on all members, class of members, creditors or class of creditors, as the case may be, if:
 - it is agreed by a majority in number representing three-quarters in value of those present and voting in person or by proxy at the relevant meeting, and
 - the arrangement is sanctioned by the court.

15.6.2 Amalgamations under ss 110–111 Insolvency Act 1986

1. A company in voluntary liquidation can carry out a transfer of its assets in exchange for shares in another company (the transferee company). The shares are then distributed to members of the transferor company.
2. The arrangement must be sanctioned by a special resolution of the transferor company. This must be a separate resolution, but it may be given at the same meeting as the special resolution required to put the company into voluntary liquidation.

3. A member who did not vote for the special resolution may write to the liquidator within seven days of the resolution being passed requiring the liquidator either to abstain from carrying out the arrangement or to purchase the member's shares at a price determined by arbitration. If invoked, this process can undermine the completion of the arrangement.