

## INVESTMENT FUNDS ALERT

### CITY CODE ON TAKEOVERS AND MERGERS – DISCLOSURE AND DERIVATIVE POSITIONS IN THE UNITED KINGDOM



This Alert summarises the changes to certain of the disclosure obligations in the UK, whereby holders of derivative positions may now need to disclose such positions if the company to which the underlying securities relate is subject to a takeover bid.

#### BACKGROUND

In recent years the United Kingdom Takeover Panel<sup>1</sup> (the Panel) has become increasingly concerned that holders of long derivative positions (in particular, total return swaps or contracts for differences (CFDs)) can build large stakes in a company that is subject to a takeover bid without having to disclose such interest either to the company or to market participants. Currently, any market participant that holds more than 1 percent of the shares in a company under offer and deals in those shares has to disclose its interest. However, this requirement does not apply to holders of derivative positions. The Panel's concerns have arisen as certain holders of derivatives have sought to control securities held by a counterparty, whilst remaining exempt from the obligation to disclose to the target or the market because they do not hold the underlying securities. Hedge funds, in particular, have been subject to criticism for attempting to influence the outcome of takeover bids while holding CFDs.

The Panel has therefore been consulting throughout 2005 on amendments to the United Kingdom City Code on Takeovers and Mergers (the Code), including changes to the disclosure obligations relating to a company during an offer period.<sup>2</sup>

The Panel published the final rules on 5 August 2005, and the changes will take effect on 7 November 2005. The amendments to the Definitions and Rule 8.3 are set out at Appendix A.

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<sup>1</sup> The United Kingdom Takeover Panel is a non-statutory regulatory body set up to ensure equality of treatment and opportunity for all shareholders in takeover bids of public companies in the UK.

<sup>2</sup> Rule 8.3 of the Code sets out the disclosure obligations of holders of interests in an offeree company during a takeover bid.

As a consequence, there may be an increased compliance burden on investment managers to monitor whether a disclosure obligation has arisen in relation to any derivative positions held in UK public companies.

## **CHANGES TO THE CODE**

The revised Rule 8.3 of the Code will require that, during an offer period, any person who is “interested” in 1 percent or more of any class of relevant securities in the offeree company must publicly disclose all dealings in relevant securities. An “interest” is any long economic exposure to price changes in the securities. This includes ownership or control, as well as a right or obligation to take delivery, and being party to derivative contracts whose value relates to the price of the relevant securities and therefore results in a long exposure. “Relevant securities” include the securities in the offeree company that are the subject of the offer.

The disclosure obligation is triggered by dealing in the interest. “Dealing” includes dealing in physical securities and derivatives (including the acquisition or disposal of, the entering into, the closing out of, exercising any rights under, or the variation of terms of such derivative).

All long positions across all interests should be aggregated to calculate the 1 percent threshold. Offsetting positions may be netted off against each other where they relate to the same class of security and the terms and counterparty are the same. The revised rules do not require disclosure where a person is solely interested in short positions in a company, but the Panel has retained the right to keep this under review and amend the Rule if necessary. A person must publicly disclose positions that it has lent but not those that it has borrowed. The Panel acknowledges that the broadening of the disclosure obligations may result in disclosure of more than 100 percent of any particular class of securities. However, it concluded that to differentiate between different interests in the same securities would be overly complicated and burdensome.

Investment managers should note that they should aggregate the interests of all customers whose assets they manage on a discretionary basis. However, there is no obligation to reveal the identity of the customer.

Interests in securities should be calculated as of midnight (London time) and all material information concerning a dealing must be disclosed by 3:30 p.m. (London time) on the day following the dealing (currently, interests must be disclosed by 12 noon) via a regulatory information service such as Reuters.

The Panel is also considering the sections of the Code that apply to stake building in a company and aims to publish proposals for change before the end of 2005.

## **GENERAL CORPORATE REPORTING REQUIREMENTS**

With regard to general English companies law, anyone holding more than 3 percent of shares in a public company must disclose its interest. However, derivatives are only included in this obligation if the holder may control or exercise the voting rights of the underlying securities or if it can require delivery of the shares. The Department of Trade and Industry is not currently considering any proposals to widen the disclosure obligations and may even narrow the definition in implementing the EU Transparency Directive to those derivatives with voting rights.

## APPENDIX A

### AMENDMENTS TO THE CODE

Set out below are the amendments to Rule 8.3 of the Code and the definitions used in Rule 8.3 that will become effective on 7 November 2005. The wording in italics are notes on the Rules as they will appear in the Code. There are additional consequential changes to the Code not reproduced here that effect the extension of the disclosure requirement under other Rules of the Code.

#### RULE 8

##### 8.3 DEALINGS BY PERSONS WITH INTERESTS IN SECURITIES REPRESENTING 1% OR MORE

(a) **During an offer period, if a person, whether or not an associate, is interested (directly or indirectly) in 1% or more of any class of relevant securities of an offeror or of the offeree company or as a result of any transaction will be interested in 1% or more, dealings in any relevant securities of that company by such person (or any other person through whom the interest is derived) must be publicly disclosed in accordance with Notes 3, 4 and 5.**

(b) **Where two or more persons act pursuant to an agreement or understanding, whether formal or informal, to acquire an interest in relevant securities, they will be deemed to be a single person for the purpose of this Rule.**

(c) **If a person manages investment accounts on a discretionary basis, he, and not the person on whose behalf the relevant securities (or interests in relevant securities) are managed, will be treated for the purpose of this Rule as interested in the relevant securities concerned. Except with the consent of the Panel, where more than one discretionary investment management operation is conducted in the same group, the interests in relevant securities of all such operations will be treated for the purpose of this Rule as those of a single person and must be aggregated (see Note 8 below).**

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#### NOTES ON RULE 8

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##### 1. *Dealings in relevant securities of the offeror*

*Where it has been announced that an offer or possible offer is, or is likely to be, solely in cash, there is no requirement to disclose dealings in relevant securities of the offeror.*

2. *Timing of disclosure*

*Both public and private disclosure required by Rules 8.1, 8.2 and 8.4(a) must be made no later than 12 noon on the business day following the date of the transaction.*

*Public disclosure required by Rule 8.3 must be made no later than 3.30 pm on the business day following the date of the transaction.*

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3. *Details to be included in disclosures (public or private)*

(a) *Public disclosure (Rules 8.1(a), 8.1(b)(i) and 8.3)*

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*A public disclosure of dealings must include the following information: –*

(i) *the total of the relevant securities in question of an offeror or of the offeree company in which the dealing took place;*

...

(iii) *the identity of the associate or other person dealing and, if different, the owner or controller of the interest;*

...

(iv) *details of any relevant securities of the offeree company or an offeror (as the case may be) in which the associate or other person disclosing has an interest or in respect of which he has a right to subscribe, in each case specifying the nature of the interests or rights concerned (see also below and Note 7(b)). Similar details of any short positions (whether conditional or absolute and whether in the money or otherwise), including any short position under a derivative, any agreement to sell or any delivery obligation or right to require another person to purchase or take delivery, must also be disclosed; and*

[Previous paragraph (vii) has been renumbered as paragraph (vi).]

...

*For the purpose of disclosing identity, the owner or controller of the interest must be specified, in addition to the person dealing. The naming of nominees or vehicle companies is insufficient. The Panel may require additional information to be disclosed when it appears to be appropriate, for example to identify other persons who have an*

*interest in the securities in question. However, in the case of disclosure of dealings by fund managers on behalf of discretionary clients, the clients need not be named.*

*Where an offeror or any person acting in concert with it acquires any interest in offeree company securities on a specially cum or specially ex dividend basis, details of that fact should also be disclosed.*

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*In the case of agreements to purchase or sell, rights to subscribe, options or derivatives, full details should be given so that the nature of the interest, position or dealing can be fully understood. For options this should include a description of the options concerned, the number of securities under option, the exercise period (or in the case of exercise, the exercise date), the exercise price and any option money paid or received. For derivatives this should include, at least, a description of the derivatives concerned, the number of reference securities to which they relate (when relevant), the maturity date (or if applicable the closing out date) and the reference price (and any fee payable on entering into the derivative).*

...

*For the purpose of the disclosure of dealings, a futures contract or covered warrant for which exercise includes the possibility of delivery of the underlying securities is treated as an option. A futures contract or covered warrant which does not include the possibility of delivery of the underlying securities is treated as a derivative.*

*If following a public disclosure made under Rule 8, interests in relevant securities are transferred into or out of a person's management, a reference to the transfer must be included in the next public disclosure made by that person under Rule 8.*

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*(b) Private disclosure (Rules 81(b)(ii) and 8.2)*

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*A private disclosure under Rule 8.2 must include the identity of the associate dealing, the total of relevant securities in which the dealing took place and the prices paid or received (in the case of an average price bargain, each underlying trade should be disclosed). A specimen disclosure form is available on the Panel's website ([www.thetakeoverpanel.org.uk](http://www.thetakeoverpanel.org.uk)) or may be obtained from the Panel. Rule 8.2 disclosures should follow that format. In the case of dealings in options or derivatives the same information as specified in Note 5(a) is required.*

...

7. *Time for calculating a person's interests*

(a) *Under Rule 8.3, a disclosure of dealings is not required unless the person dealing is interested in 1% or more of any class of relevant securities at midnight on the date of the dealing or was so interested at midnight on the previous business day.*

(b) *For the purposes of Note 5, the interests and short positions to be disclosed are those existing or outstanding at midnight on the date of the dealing in question.*

(c) *A person will be treated as interested in relevant securities for the purposes of this Note 7 and Rule 8 if, he has disposed of an interest in relevant securities before midnight on the date in question, but there exists an agreement, arrangement or understanding, formal or informal, of any nature (but not itself amounting to an interest in the securities) as a result of which he is entitled, or would expect to be able, to acquire an interest in the securities concerned (or equivalent securities) thereafter.*

8 *Discretionary fund managers*

*The principle normally applied by the Panel is that where the investment decision is made by a discretionary fund manager, he, and not the person on whose behalf the fund is managed, will be treated as interested in, and having dealt in, the relevant securities concerned ...*

...

9. *Principal traders*

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*...For example, a dealing in relevant securities by a principal trader, backed by a firm commitment by a person to purchase the relevant securities from the principal trader, will be regarded as a dealing by that person. ...*

...

14. *Irrevocable commitments and letters of intent*

*A disclosure of the procuring of an irrevocable commitment or a letter of intent must provide full details of the nature of the commitment or letter including:*

(a) *the number of relevant securities of each class to which the irrevocable comment or letter of intent relates;*

...

and 5 on Rule 10 may be counted, other than those which fall within paragraph (c)(iii) of Note 4 or Note 8.

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## DEFINITIONS

### Associate

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“It is not practicable to define associate in terms which would cover all the different relationships which may exist in an offer. The term associate is intended to cover all persons (whether or not acting in concert) who directly or indirectly are interested or deal in relevant securities of an offeror or the offeree company in an offer and who have an interest or potential interest, whether commercial, financial or personal, in the outcome of the offer.”

...

### Dealings

“A dealing includes the following:

- (a) the acquisition or disposal of securities;
- (b) the taking, granting, acquisition, disposal, entering into, closing out, termination, exercise (by either party) or variation of an option (including a traded option contract) in respect of any securities;
- (c) subscribing or agreeing to subscribe for securities;
- (d) the exercise or conversion, whether in respect of new or existing securities, of any securities carrying conversion or subscription rights;
- (e) the acquisition of, disposal of, entering into, closing out, exercise (by either party) of any rights under, or variation of, a derivative referenced, directly or indirectly, to securities;
- (f) entering into, terminating or varying the terms of any agreement to purchase or sell securities; and
- (g) any other action resulting, or which may result, in an increase or decrease in the number of securities in which a person is interested or in respect of which he has a short position.”

## **Derivative**

“Derivative includes any financial product whose value in whole or in part is determined directly or indirectly by reference to the price of an underlying security.”

### *NOTE ON DEFINITION OF DERIVATIVE*

*The term “derivative” is intentionally widely defined to encompass all types of derivative transactions. However, it is not the intention of the Code to restrict transactions in, or require disclosure of derivatives which are not connected with an offer or potential offer.*

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## **Interests in securities**

*This definition and its Notes apply equally to references to interests in shares and interests in relevant securities.*

“A person who has long economic exposure, whether absolute or conditional, to changes in the price of securities will be treated as interested in those securities. A person who only has a short position in securities will not be treated as interested in those securities.

In particular, a person will be treated as having an interest in securities if:-

- (1) he owns them;
- (2) he has the right (whether conditional or absolute) to exercise or direct the exercise of the voting rights attaching to them or has general control of them;
- (3) by virtue of any agreement to purchase, option or derivative he:
  - (a) has the right or option to acquire them or call for their delivery; or
  - (b) is under an obligation to take delivery of them,

whether the right, option or obligation is conditional or absolute and whether it is in the money or otherwise; or

- (4) he is party to any derivative:
  - (a) whose value is determined by reference to their price; and
  - (b) which results, or may result, in his having a long position in them.”



## NOTES ON INTERESTS IN SECURITIES

### 1. Gross interests

*The number of securities in which a person is treated as having an interest is normally the gross number, aggregating the number of securities falling under each of paragraphs (1) to (4) above. If an interest in securities falls within more than one paragraph, the person shall be treated as interested in the highest number determined under the relevant paragraphs.*

*If each of the following conditions is met, the Panel will normally allow offsetting positions to be netted off against each other:*

- (a) the offsetting positions are in respect of the same class of relevant security;*
- (b) the offsetting positions are in respect of the same investment product;*
- (c) save for the number of securities in question, the terms of the offsetting positions are the same, e.g. as to strike price and, if appropriate, exercise period; and*
- (d) the counterparty to the offsetting positions is the same in each case.*

### 2. Interests of two or more persons

*As a result of the way in which interests in securities are categorised, two or more persons may be treated as interested in the same securities. For example, where a shareholder grants a call option to another person, the shareholder will be interested in the shares the subject of the option as a result of paragraph (1) of the definition of interests in securities, and the option holder will be interested in those shares as a result of paragraph (3) of the definition.*

#### *(3) Number of securities concerned*

- (a) Where the number of securities the subject of an agreement to purchase, option or derivative is not fixed, a person will normally be treated as interested in the maximum possible number of securities.*
- (b) Where the value of any derivative is determined by reference to the price of a number of securities multiplied by a particular factor, a person will be treated as interested in the number of reference securities multiplied by the relevant factor:*
- (c) Where a derivative is not referenced to any stated number (or maximum number) of securities, a person will normally be treated as interested in the gross number of securities to changes in the price of which he has, or may have, economic exposure.*

4. *Securities borrowing and lending*

*If a person has borrowed or lent securities, he will normally be treated as interested in any securities which he has lent but will not normally be treated as interested in any securities which he has borrowed. If a person has on-lent securities which he has borrowed, he will not normally be treated as interested in those securities.*

5. *New shares*

*Where a person holds securities convertible into, or warrants or options in respect of, new shares, he will be treated as interested in those securities, warrants or options but will not be treated as interested in the new shares which may be issued upon conversion or exercise. However, the acquisition of new shares on conversion or exercise of any convertible securities, warrants or options will be treated as an acquisition of an interest in the new shares which are then issued.*

6. *Proxies and corporate representatives*

*A person will not be treated as having an interest in securities by reason only that he has been appointed as a proxy to vote at a specified general or class meeting of the company concerned, or has been authorised by a corporation to act as its representative at any general or class meeting or meetings.*

7. *Security interests*

*A bank taking security over shares or other securities in the normal course of its business will not normally be considered to be interested in those shares or securities.*

8. *Companies Act 1985*

*This definition applies only in respect of the relevant provisions of the Code. Separate provisions dealing with “interests in shares” are contained in the Companies Act 1985. Any Panel view expressed in relation to interests in securities can only relate to the Code and should not be taken as guidance on the interpretation of such statutory provisions.*

**Irrevocable commitments and letters of intent**

“Irrevocable commitments and letters of intent include irrevocable commitments and letters of intent to accept or not to accept (or to procure that any other person accept or not accept) an offer and also irrevocable commitments and letters of intent to vote (or to procure that any other person vote) in favour of or against a resolution of an offeror or the offeree company in the context of the offer.”

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**Relevant securities**

“Relevant securities include:

- (a) securities of the offeree company which are being offered for or which carry voting rights;
- (b) equity share capital of the offeree company and an offeror;
- (c) securities of an offeror which carry substantially the same rights as any to be issued as consideration for the offer; and
- (d) securities of the offeree company and an offeror carrying conversion or subscription rights into any of the foregoing.”

## CONTACT INFORMATION

If you have any queries regarding the changes to the Code, or need assistance regarding its practical consequences, please contact:

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