

Client Alert

Latham & Watkins
Corporate and Tax Department

UK Takeovers: Defined Benefit Pension Trustees Gain New Rights.

Over eighteen months have now passed since wide-ranging changes to the UK Takeover Code were introduced in September 2011. Further changes in respect of target company defined benefit pension plans were announced on 22 April 2013 and will be implemented on 20 May this year, marking the beginning of a new round of changes, implementation of which is expected to take place throughout 2013.

This *Alert* sets out the new pension trustee information and opinion publication rights in UK takeovers to take effect on 20 May 2013, and also looks forward to other proposed changes to the Code that are expected to further shape the UK's public M&A landscape in 2013.

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The Introduction of Rules in Favour of Pension Trustees

The Takeover Panel's broad review of takeover regulation in 2011 resulted in a number of amendments to the Code applied for the benefit of a target company's employees and their representatives. These included making more prominent: (i) a bidder's obligations to disclose its intention with regard to the continued employment of employees and management of the target company and the impact its strategic plans will have on employees; and (ii) the ability of employee representatives to comment on these matters. Following a recent public consultation, the Takeover Panel has now approved changes providing broadly similar benefits to the trustees of a target company's defined benefit pension scheme(s) where a target has such pension arrangements in place for current or former employees.

The overriding aim of these changes is to create a framework within which the takeover parties and the trustees of defined benefit pension schemes have an opportunity to express their views on a takeover's anticipated effects, if any, on those pension schemes. The Takeover Panel has emphasized that this framework is not intended to ensure that offers are only declared unconditional once a bidder and the trustees of the pensions scheme(s) have reached agreement on the future arrangements for the scheme. The changes, which will take effect for all current and future offers on Monday 20 May 2013, are as follows:

- a new definition of "pension scheme" meaning that the new Code rules will apply to any occupational pension scheme that: (i) is a funded scheme sponsored by the target company (or any of its subsidiaries); (ii) provides pension benefits, some or all of which are on a defined benefit basis; and

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(iii) has trustees (or managers, in the case of a non-UK scheme). This will encompass pension schemes (irrespective of size) on a group-wide basis, whether or not they are in the UK, but specifically excludes "defined contribution" schemes where the amount of the employer's annual contribution is specified and the employer's liability is capped to the contributions made and is not tied to the former employee's service or the investment performance of the plan;

- a requirement that the bidder states in the offer document its intentions with regard to the impact the offer will have on the benefits provided to the target company's pension schemes and its members, *i.e.* employer contributions into the benefits scheme, the accrual of benefits for existing members of the scheme and the admission of new members to the scheme (so called 'benefit impacts'). The changes do not require the bidder to make statements with regards to 'covenant impacts' *i.e.* there is no need for an assessment of the future ability of the target company to meet its funding obligations to the scheme;
- if the bidder has no intention of making any changes in relation to the target company's defined benefit pension scheme(s), or if it considers that its strategic plans for the target company will have no repercussions on the scheme(s), the bidder is required to make a statement to that effect;
- unless otherwise stated, parties to an offer will be regarded as being committed to statements made regarding a target company's pension scheme(s) for a period of 12 months from the end of the offer unless another period is stated as applying (or unless there has been a material change in circumstance);
- pension trustees will be entitled to receive the same documents that the bidder or target board are required to make available to employee representatives, namely: announcements commencing offer periods, firm offer announcements, the offer document (and any revised offer document) and the target board's circular relating to the offer (and any revised offers); and
- pension trustees will be given the opportunity to publish an opinion, to be appended to the target company board's circular or, if not received in good time for the board's circular, then published on the target's website and released as a market announcement. The trustees' opinion, if they choose to publish one, will be limited to the effects of the offer on the pension scheme(s) but can include an opinion on both the benefit impacts and covenant impacts. The target company is not required to pay for the costs incurred by pension scheme trustees in obtaining advice required in order to verify the information contained in an opinion. Target company boards will not have to express an opinion on the effect of the offer on pension schemes, but there will be no restrictions on them doing so if they choose to or taking such matters into account when formulating their views on the offer.

Whilst the new rules do not require that information regarding the target company's pension scheme(s) is provided to a bidder, the bidder will still be under an obligation to explain the impact the offer will have on the benefits provided by any defined benefit pension scheme and its members in its offer document. There is therefore scope for bidders to have incomplete information from which to make this potentially complex assessment in situations where the target and/or the trustees of a target company's pension do not provide the bidder with information, as may be the case most obviously in hostile bid situations. In the context of a recommended transaction, agreement is often, but not always, reached between a bidder and the pension trustees in advance of the offer document being published (*e.g.* if required due to funding deficits or change of control provisions). However, the Panel has made clear that the new rules are not intended to require that any such agreement between the bidder and the trustees is reached in advance of an offer

being announced, or indeed before any offer is declared unconditional. Further, in the event that agreement is not possible between a bidder and the trustees of the target's pension scheme (*i.e.* concerning deficit funding arrangements), the new Code rules do not envisage that the transaction be automatically referred to the Pensions Regulator ("tPR"). The Takeover Panel rejected this proposal, following discussions with tPR, since the Panel does not currently have powers of referral to regulatory bodies prior to offers becoming unconditional and tPR's clearance process is voluntary.

Where agreement is reached between the bidder and the trustee of the target company's pension scheme(s) on future funding it will be treated under the Code in the same way as other agreements entered in connection with the offer *i.e.* where it is a 'material contract' of the bidder, it is required to be published on a website. If it is not a 'material contract' there is no requirement to disclose the full terms of the agreement, and the Code will be amended to make this clear in respect of the existing rules on document publication. However, a 'summary' of any agreement reached with trustees regarding any future funding obligations will always need to be included in the firm offer announcement and offer document.

Employee representatives have responded to the 2011 revisions to the Code and the additional prominence given to their rights to publish opinions with a marked rise in the number of employee representative consultations and opinions published in connection with takeover offers. From 2006, when the rights were introduced to the Code to reflect the requirements of the EC Directive on Takeover Bids, only three employee representative opinions had been published in connection with takeover offers prior to the Takeover Panel's 2010/2011 review. In due course, it will be of interest to see if pension trustees are as active as employee representatives in using these new information and opinion rights and if the obligations on offerors to state their intentions regarding the target's defined benefit pension scheme results in earlier dialogue between bidders and the scheme trustees. By extending the rules in this way, the Takeover Panel has restated its view that offer documentation published in the context of an offer is not only for the benefit of target shareholders, and other stakeholders have an interest in receiving relevant information and making their opinion publicly known.

Further Changes on the Horizon for 2013

In late September 2012, the Panel closed on two further market consultations regarding:

1. The proposed extension of the Code's regulation to cover certain companies which may not currently be managed and controlled within the jurisdictions of the United Kingdom, the Isle of Man or the Channel Islands of Jersey and Guernsey (the "Code Territories").

Whilst details of the exact proposed changes to the Code are awaited, the Takeover Panel has proposed to remove the residency test to significantly widen the jurisdictional application of the Code with the effect that any public company (or qualifying private company) incorporated in the Code Territories will be subject to the Code's jurisdiction irrespective of where it is managed and controlled (or on whichever market or exchange, if any, its securities may be admitted to trading). For example, a UK/Jersey/Guernsey or Isle of Man incorporated company trading on an overseas stock exchange such as Nasdaq, NYSE, SGX or the Hong Kong Stock Exchange would be subject to the Code if the rule changes are introduced. This is reminiscent of the times in the Code's past when its jurisdictional reach was considerably broader.

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2. The relaxation of the rules on profit forecasts made in the ordinary course prior to and during an offer period

The Takeover Code currently requires that parties to an offer must have reporting accountants and financial advisers confirm the accuracy of certain profit forecasts and estimates made prior to and during an offer period, or which are repeated during an offer period. There are currently a limited number of available dispensations to this broad requirement. The purpose of the rule is to seek to ensure that in the context of a takeover offer the boards of target companies (in particular in hostile offer situations) and bidder companies (where bidder securities are being offered as consideration) do not promote their company's future projections without subjecting those figures to proper scrutiny.

However, the increase over recent years in the number of UK companies issuing interim management statements in the ordinary course of their business has meant that often such statements need to be reported on, even if not made with regard to a possible offer or, in the case of a bidder, if the takeover transaction is relatively immaterial to a bidder board issuing paper consideration to target shareholders.

The proposed new rules on profit forecasts will completely re-write the provisions of the Code applying to this area of practice. In summary it is proposed that:

- the definitions of what constitutes a profit forecast and a profit estimate are more closely aligned with those contained in the Listing Rules applying to companies admitted to trading on the Official List of the London Stock Exchange, and shall (absent a dispensation) also apply equally to forecasts concerning a business division;
- in relation to statements made (whether in the ordinary course or not) prior to the commencement of an offer period and when no possible offer is in contemplation, accountants' reports and financial adviser's reports will not normally be required. However, the directors will be required to confirm at the time of the publication of the offer document or target board circular (as applicable) whether the forecast remains valid or not, or include a new forecast which must be reported on;
- in relation to most ordinary course statements made following the commencement of an offer period (or when an offer was contemplated), an accountants' report and financial adviser's report will be required unless each other party to the offer(s) consents (in which case, a directors' confirmation, as above, will be required). If consent is not provided, then reporting will be required;
- in relation to statements made following the commencement of an offer period (or when an offer was contemplated) in which a management team led/sponsored buy-out or controlling shareholder is a potential or actual bidder, reporting will always be required;
- in all instances of a profit forecast being published (including those which were made before an approach was made but which remain outstanding, or where a dispensation to reporting is given by the Takeover Panel), the directors will be required to give details of the assumptions and accounting policies on which the forecast is based; and
- in relation to non-ordinary course statements made with projections ending less than 15 months from the date of the statement, a reporting obligation will always be required. However, where the profit forecast projections end more than 15 months from the date of first publication, the Panel has said that a dispensation from reporting requirements will normally be granted (irrespective of whether the statement is made outside of the ordinary course or a management team led/sponsored buy-out or controlling shareholder is a potential or actual bidder).

Next Steps

The Code rule changes concerning pension trustee rights will take effect on 20 May 2013.

The changes to the Code rules on the jurisdiction of the Code and on the reporting of profit forecasts are expected to be introduced later in 2013 following the publication of further Panel response statements addressing the closed consultations on those matters. Further *Alerts will be issued to consider each of the changes in detail after the Takeover Panel publishes the final Code rule changes to be implemented.*

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