Practice Note 17 (PN17) – Issues relating to special deals and Rule 25 of the Takeovers Code

Rule 25 of the Takeovers Code, which reflects the provision in General Principle 1 that all shareholders should be treated equally, provides that *"[e]xcept with the consent of the Executive, neither the offeror nor any person acting in concert with it may make any arrangements with shareholders or enter into arrangements to purchase or sell securities of the offeree company, or which involve acceptance of an offer, either during an offer or when an offer is reasonably in contemplation or for six months after the close of such offer if such arrangements have favourable conditions which are not to be extended to all shareholders."*

It follows from Rule 25 that special deals are generally not permitted unless the Executive provides the requisite consent. The Notes to Rule 25 set out a number of specific scenarios under which the Executive may grant such consent. In practice the Executive has encountered some issues in respect of applications for consent to transactions that constitute special deals but are not explicitly covered by the Notes to Rule 25. The Executive has sought the Takeovers Panel's guidance in this regard.

Executive's current approach to special deals

The Panel endorsed the Executive's current approach to special deals which can be summarised as follows:

(i) If a special deal arrangement is capable of being extended to all other shareholders, it should be so extended;

(ii) If a special deal arrangement is not capable of being extended to shareholders but the special benefit received by the counter-party shareholder(s) can be quantified, the value of the benefit should be appropriately reflected in the offer price;

(iii) If a special deal arrangement is not capable of being extended and the special benefit conferred on the counter-party shareholder(s) cannot be quantified, in cases where considered appropriate, the Executive may consent to these deals subject to compliance with the requirements of Note 4 to Rule 25, in particular, that (a) an independent financial adviser to the offeree company publicly states that in its opinion the terms of the transaction are fair and reasonable; and (b) the transaction is approved at a general meeting of the offeree

company's shareholders who are not involved in or interested in the transaction.

Examples of the third type of arrangement mentioned above include:

(a) Sale of assets between the offeror and a shareholder – most often by its very nature the sale of an asset is not capable of being extended to all shareholders. In practice difficulties arise regarding such sales if they constitute special deals and cannot be valued (such as the sale of a brand or an asset that includes "goodwill" value) and hence it is not possible to extend the benefit to all shareholders;

(b) The entering into of business, shareholders' or other co-operation agreements between the offeror and a shareholder – again it is often highly problematic if not impossible to ascribe an objective value to an agreement, in particular, one that relates to co-operation; and

(c) Service and management agreements between the offeree company and outgoing shareholders or senior management - examples of such incentives might be enhanced contractual terms, share options grants from the offeror, or a position on the board of the offeror. Given that management incentives can be substantial, the Executive believes that the process for applying for the Executive's consent to service or other management contracts should be no less stringent than that for a disposal of offeree assets (i.e. the full Note 4 requirements should apply).

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