17 February 2006

ICAEW Rep 09/06

The Secretary to the Code Committee
The Panel on Takeovers and Mergers
10 Paternoster Square
London
EC4M 7DY

Dear Madam/Sir

Re: PCP 2005/3 "Dealings in Derivatives and Option. Detailed proposals relating to amendments proposed to be made to the Takeover Code"

The Corporate Finance Faculty of the Institute of Chartered Accountants in England and Wales ('The Institute') welcomes the opportunity to comment on Takeover Panel PCP 2005/3 – "Dealings in Derivatives and Option. Detailed proposals relating to amendments proposed to be made to the Takeover Code", issued by the Code Committee of the Panel (the "PCP") on 2 November 2005. We have reviewed the proposals and set out below our responses to the questions posed in the consultation paper.

The Institute is the largest professional accountancy body in Europe, with over 126,000 members. Its Corporate Finance Faculty is the largest community of professionals involved in corporate finance with over 5,300 members and more than 50 member firms. Many of our members have wide-ranging experience of public company takeovers and, in preparing our response, we have used their experience and comments.

We have taken some time to review the PCP and, whilst we are broadly sympathetic with what we believe the Code Committee is trying to achieve, we have some fundamental concerns about some of the proposals.

There have been occasions when a potential bidder has acquired shares of up to, say, 29.9% and taken an option or a CFD over a further, say, 21% without triggering Rule 9 and permissible within Rule 5. This has had the effect of 'locking up' the target company such that no one else can bid, because the shares subject to the option or hedged against the CFD are effectively subject to a right of pre-emption in favour of the counterparty. In this case the question of whether control over these shares has passed is not the issue, but it is more a case of 'negative control'.

Further, we are aware of cases where a similar situation to that outlined above has occurred, and where it would appear that control over the shares had passed, but that it was impossible to prove this fact.

We are broadly of the view that the Panel should try to put in place safeguards that make the above two scenarios more difficult to achieve for a potential bidder. However, it is not always the case that *de facto* control has passed. Similarly, we consider that it is inconsistent for the Code Committee to be suggesting differing treatments of options and derivatives in respect of Rule 9 and the acceptance condition.

Whilst we agreed with the proposals relating to disclosure of derivatives and options as set out in PCP 2005/2, we do not agree that the acquisition of an economic exposure with no associated voting control should trigger the provisions of Rule 9. Broadly, we had always understood that Rule 9.1 was designed to ensure that shareholders in a Code company were not disadvantaged by the emergence of a new controlling party (or the consolidation of control by a person or group of persons) by requiring a mandatory offer allowing shareholders the opportunity to achieve an exit for cash.

Whilst we recognise that in some situations *de facto* control may pass from a counterparty to the person concerned (with the associated Rule 9 consequences), we fail to understand the philosophy behind the requirement for a mandatory offer where no control has been achieved or consolidated. We consider that the Panel should continue to look at situations on a case by case basis taking into account the relevant facts rather than there being no requirement for the Panel to prove that actual control over any hedge shares has passed to the person concerned. Alternatively, the Panel may consider that they should be able to draw a presumption that control had passed as regards certain derivative and option positions but that such presumption may be rebutted (possibly subject to certain listed criteria). The current definition of 'interests in securities' lends itself to this possibility but does not make it explicit.

We are also concerned that the proposed changes are very complex, even for the experienced practitioner, and believe that if the changes were to be made to the Code, explanatory seminars would need to be offered to the public in order for them to fully grasp the wide implications of these proposals.

It is also unclear how these provisions might affect other areas of the Code such as whether the acquisition of a long derivative would constitute a disqualifying transaction for the purpose of any whitewash or as to how the Panel proposes to deal with concert parties that form with greater than 30% of the share capital (we understand that currently no bid is required on the formation of the concert party, but is if either party acquires more shares). How is this different in substance from the relationship between two parties to an option agreement over shares which would require a bid under the current revision proposal?

We attach as an Appendix our responses to the specific questions raised. We have focussed on the questions that are most likely to affect our members. We hope you will find these comments helpful.

Should you wish to discuss any matters contained in this response please do not hesitate to contact me. We would be delighted to meet with you to discuss our views further if required.

Yours faithfully

Vera Sabeva
Head of the Corporate Finance Faculty
Institute of Chartered Accountants in England and Wales
Tel. 020 7920 8796
E-mail vera.sabeva@icaew.co.uk

APPENDIX

Q1 – Do you agree with the proposed amendments in order to implement the broad approach?

We do not agree. We are not persuaded by the arguments set out in the PCP. We do not consider that an option holder and a holder of a derivative necessarily has *de facto* control over the underlying shares whether or not the position is hedged (unless a separate arrangement is in place) and we disagree that Rule 9 should apply to options and derivatives where it can be demonstrated that no control has passed from the counterparty to the person concerned. We disagree, therefore, with a number of the associated Code changes resulting from the proposed changes to Rule 9. Derivatives can take a myriad of forms and with many derivatives there is a real lack of transparency as to what action the counterparty may take to hedge its position. Often a party entering into a long derivative will have no right over any shares bought by the counterparty to hedge the position.

We have more sympathy with the proposals under Rule 5, to treat derivatives and options as interests in shares, and would broadly agree with the proposed changes to Rule 5.

Q2 – Do you agree with the Code Committee's conclusions regarding the acceptance condition under Rules 9.3(a) and 10? In particular, do you agree that only shares, and not interests in shares arising by virtue of derivatives and options, should be taken into account under Rule 9.3(a)?

We agree that only holdings in shares should count for the acceptance condition under Rule 9 and Rule 10, but note that this is inconsistent with the proposals to include the acquisition of options and derivatives as giving rise to a mandatory offer. On the one hand, it is proposed by the Panel that the acquisition of options and derivatives gives *de facto* control, yet, on the other hand, these 'control' positions do not count towards the acceptance condition. We consider that this is also inconsistent and it is possible to conceive that, if these options and derivatives did count towards the acceptance condition (which we do not agree with), on offers becoming unconditional as to acceptances (or not), bidders might thereafter still be prevented from acquiring further shares or interests in shares if, after the offer, they held less than 50% of the total shares in a Code company.

Q3 – Do you agree with the Code Committee's conclusions and proposals regarding the 30% to 50% bands?

We do not agree with the way in which the Panel is proposing to change the limits of the bands for the 30-50% range because we do not agree with the "broad approach" to Rule 9 as outlined in the PCP.

Q4 – Do you agree with the proposed amendments in relation to the price at which an offer is required to be made as described in paragraph 6 above?

We do not agree with the 'broad approach' and thus we cannot understand the philosophy that derivative positions and options (un-exercised) should be relevant for Rules 6, 9 and 11. If one concluded that they should be relevant, we would suggest that the applicable pricing should be as simple as possible. We would suggest that for a derivative it should be the highest derivative reference price. The other approaches sound complicated and we consider that it is not necessarily the derivative holder who determines whether a hedge is entered into and the pricing of any such hedge.

Q5 – Do you agree with the proposed amendments in relation to changes in the nature of a person's interest as described in paragraph 7 above?

We do not agree, as these changes only follow if the 'broad approach' is accepted.

Q6 – Do you agree with the proposed amendments in relation to the single shareholder exception?

We do not agree as these changes only follow if the 'broad approach' is accepted.

VS/17.2.06