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## Tying the knot

Making sense of mergers

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## Tying the knot

Companies are tremendously complex webs of people, data, processes, assets and legal objects – simply keeping them running without incident takes a great deal of work.

With that in mind, stop to consider for a moment what it means to merge two businesses successfully. Not only do you have to keep up with the everyday tasks, but as someone working in a company secretarial team, you'll be responsible for unravelling, documenting and then integrating two (or more, in the case of merging groups) companies, with all their associated operations and obligations. For those who have yet to experience their first large corporate action, it's a potentially nerve-wracking prospect.

While we would be remiss to suggest that this issue of *ICSA Focus* is a 'comprehensive guide to a successful merger', it should give you an idea of what you can expect – or if you've already been through a merger, what you could perhaps do differently next time around. The whole point of a merger is to offer operational and strategic advantages to both parties, and if you know what to expect from a corporate action, it could offer the same thing to you.

### Gareth Pearce

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If you are lucky enough to be involved in an acquisition or merger during your company secretarial career, there is much to gain as a learning experience. You can also add a great deal of value to your organisation by ensuring that the whole process is rigorous and runs smoothly.

The company secretaries that we have interviewed agree that resource is the very first thing to be considered in a merger situation. Will you be able to get the day job done with existing resources? If day-to-day compliance suffers, the company could be put at risk. Adding an interim company secretary or other legal resource that has experience of corporate transactions will add value to your team, and allow them to learn from the shared expertise.

Like many transactions, all the focus is on closing the deal: but it is after that happens – when all the advisors have taken a step back – that mountains of work fall on the shoulders of the company secretary. Whether it is integrating share plans or statutory registers on different platforms, carrying out reconciliations and health checks or re-assigning work and re-structuring company secretarial teams, there is still a lot to do.

This extra work can be turned into a positive – not only can company secretaries take advantage of the many opportunities which arise to make efficiencies and improve processes, but every step taken adds to their experience and knowledge.

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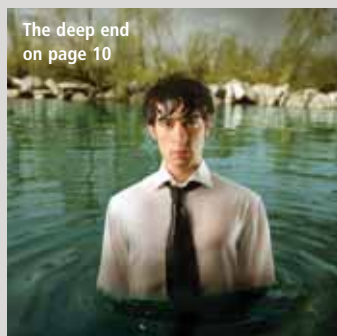
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# All part of the process

**Madeleine Cordes** provides an overview of the nuts and bolts of the takeover and merger process.

**W**hether you are involved as a company secretary in a merger of two companies at some point in your career – either by way of

a takeover or a scheme or arrangement – can very much be a matter of chance. You may be specifically employed as an interim resource to help the two companies looking to merge, or the bidder or target company

through this type of corporate activity. Alternatively you may just find yourself working for a company at a time when it finds itself on one side or another of a merger or acquisition.

In this article I explain the main elements and the typical process and timetable of a merger as it proceeds. I also highlight the considerations and issues the company secretaries of both bidder and target companies will face and their interaction with the companies' registrars.

The City Code on Takeovers and Mergers is the set of rules which governs the majority of takeover and merger situations which can arise. The Takeover Panel has a number of powers under the Companies Act 2006 to enforce these rules. A number of other laws also apply to takeovers – the Listing Rules, the Disclosure and Transparency and Prospectus Rules, and the merger provisions



of the Companies Act can have an effect. The Competition Commission deals with referrals of mergers by the Office of Fair Trading (OFT) where the OFT believes competition law has been breached. The Competition Commission has the final say on whether to clear or veto the merger.

The Takeover Code sets out the structure and timetable of takeovers of various categories of companies. Broadly speaking these are:

- those companies (whether UK or overseas registered in the European Economic Area (EEA)) which have shares listed in the UK, the Channel Islands or the Isle of Man;
- 'public' but not necessarily 'listed' UK registered companies which have their principal place of operation in the UK, Channel Islands or the Isle of Man; and
- private UK companies which have shares

listed in the EEA or overseas registered EEA companies with a place of operation in the UK.

#### **Bidding companies**

The company secretary is likely to be heavily involved, together with the board and the company's advisors, in the planning to make a bid – including setting up a board committee and carrying out extensive due diligence on the target group.

At this stage, secrecy is imperative and the company secretary can ensure the board is reminded of the rules and limitations on share dealing, their directors' responsibilities and the disclosure of inside information.

A bidding company may decide to build up a stake in the target company. Any company that holds more than 3 per cent of another company must declare its holding under the Disclosure and Transparency Rules in relation to announcement of significant shareholdings. Under the Takeover Code, any company that builds up a greater than 30 per cent stake in another firm may be required to make a mandatory offer for that firm. Care must also be taken with the 'concert party' rules. A detailed analysis of the shareholder register of the target company will need to be carried out. If there are very significant holdings by other investors they could block a takeover.

The company secretary of a potential bidder company will need to consider with the company's advisors what sort of shareholder approvals will be required. Depending on the size of the proposed transaction, it could represent a Class 1 transaction under the Listing Rules – this requires a shareholder circular and a general meeting. As with any general meeting, the registrar to the company will assist in organising this, reviewing draft proxy cards and providing an ongoing analysis of the voting position as the votes are received prior to the meeting. The company secretary will need to attend to the Companies House filings and announcements to the market following the meeting.

to complete the company's record of the beneficial ownership of its issued share capital. Any unexpected movements in shareholdings or untoward changes in share price should be quickly investigated with the company's brokers and reported back to the board by the company secretary. The company secretary should also ask the registrars to advise them of any requests for inspections of the shareholder register. Keeping a close eye in this way may alert the company to the existence of a possible bidder.

#### **Takeover or scheme of arrangement?**

A key consideration will be whether to go the takeover 'offer' route or to utilise a scheme of arrangement. Schemes of arrangement are commonly used in the case of 'all share' mergers and where the companies are of similar sizes. In recent years two-thirds of all mergers in the UK have used the scheme of arrangement route.

It differs from a takeover in that the target company puts the arrangement to its shareholders, rather than the bidder making an offer to the target company's shareholders. Schemes of arrangement are therefore intended for 'recommended offer' situations in which the board has a preferred bidder.

It is potentially easier to have a scheme of arrangement approved – only 75 per cent of the value of shares voted and 51 per cent of shareholders voting are required. A takeover, by contrast, requires acceptances of 50 per cent of the issued share capital. There are other differences – a scheme of arrangement does require approval by the courts, but on the other hand, may not require the production of a prospectus (a huge boon for the company secretary – prospectuses can be a huge undertaking).

#### **Scheme of arrangement**

The process typically involves application to the court, a notice sent to shareholders to convene the meeting and explaining the scheme, and approval given at a meeting

Any unexpected movements in shareholdings should be investigated.

#### **Target companies**

It is critical that company secretaries of likely takeover targets must maintain a close watch over the company's share register through regular and accurate shareholder analysis by their registrar's investor relations team. Notices should be sent to any unknown nominee shareholders (under Section 793 of the Companies Act 2006) on the register

convened at court and sanction by the court. This route gives certainty of 100 per cent acquisition of shareholdings. The process can be relatively efficient and be completed in only two months. Many of the processes of announcements, shareholder approvals and negotiations between the two companies are the same as under the takeover offer process detailed below, especially if



# Mergers and acquisitions

All part of the process continued from page 5

the companies involved are publicly listed companies. It is not unknown for schemes to switch to a takeover offer, or vice versa, during a transaction. The company secretary and their team will need to provide substantial support to the board if a company chooses the scheme route – the chairman especially will need support when he takes part in the scheme meeting and court dates.

## Takeover process

The takeover may be 'recommended', where the target is approached in advance, or 'hostile', where the target is taken by surprise. Takeovers involving an offer of shares will require a prospectus, or a 'document equivalent to a prospectus' under the Prospectus Rules. The company secretary should expect to be heavily involved in the drafting and reviewing of this document, which will contain a financial snapshot of both companies' assets and liabilities, as well as the rights attached to the shares on offer. It should be noted that the bidder company may structure the transaction as a scheme of arrangement instead of an offer of shares.

The bidder company will be obliged to make an announcement to the market of its intention to make an offer. The announcement must contain specific information as set out in the Code. Both the bidder and target companies must inform their employees of the offer and, in addition, the target company must inform its shareholders of the announcement.

The bidder company may make a holding announcement of a possible offer and the target may then ask the Takeover Panel to impose a time period in which the bidder is required to 'put up' (an offer) or 'shut up' (withdraw its intention to make the offer).

The offer timetable drives the whole process. It starts with a 28-day period in which the bidder (and target if it is a recommended offer) must prepare and send to target company shareholders an offer document. This document must contain an offer which is open for at least 21 days and an explanation of the rationale for the bid, future plans for the larger group and for the employment of the target company's employees. It will also explain, if the transaction is a Class 1 transaction, that the bidder's shareholders must approve the offer before a deal can be accepted by the board. The company secretary will be heavily involved in the verification of statements process as this document is drafted, and will also be responsible for making statutory information available to advisors.

In the case of a hostile bid, the target company has 14 days from the date of

the bid to produce a defence document to send to shareholders. Offer periods may be extended and better terms offered. Often, 90 per cent acceptances are required from shareholders, should the bid succeed the minority shareholdings will be compulsorily acquired. However, at least 50 per cent acceptance from the target shareholders will be required under the Code. The bidding company registrar's corporate actions team will generally be instructed to deal

put in place arrangements for enabling e-communications through updates to their articles of association and liaison with the companies' registrars.

As well as often inheriting hundreds of new companies from the target company group structure, the company secretary may be left with a 'dissentient/lost shareholder' register which the registrars of the new group will have to continue to maintain. The registrar can help to locate



## Secrecy is imperative.

with the acceptances process – they will regularly report to the company on the level of acceptances achieved. Shares in the bidder company may be issued to pay out shareholders of the target company. If the takeover succeeds, the whole process to payment of shareholders should take about three months.

## E-comms

The Takeover Code was amended and various new rules introduced in March 2009 to enable companies to use electronic forms of communication, including website publication, to send documents, announcements and information to target company shareholders and persons with information rights. Under the Companies Act 2006 these procedures have been available since 2007 for companies to use in their day-to-day dealing with their shareholders. Many companies have

missing shareholders by running a focused identification programme, which should gradually reduce the size of the register over time as shareholders are paid out.



There will be many more practical issues for the company secretary to pick up during and following the merger. In her article, *The deep end* (see page 10), Madeleine Cordes shares the experiences of company secretaries who have been involved in a number of different mergers, including their advice on how to ensure the process is as painless as possible in what can be difficult circumstances. ■

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# Dotting the I's

**Tim Bird** looks at how to carry out effective due diligence for M&A transactions from the perspective of the seller.

**B**efore any merger or acquisition can proceed, the company secretary must carry out a due diligence process. Company secretaries, together with their in-house legal team, are typically involved in determining what should be expected of their company, its directors and the wider transaction team in such a process. The precise due diligence requirement for a transaction will depend on various factors, including:

- whether the target company is a private or a public company;
- whether the transaction is an auction with a number of potential buyers or a negotiated 'standard' sale to a single buyer;
- the industry concerned; and
- the risk appetite of the parties.

All too often due diligence is considered in the context of the bidder, but it is the target that will be required to populate and maintain a data room.

## **The purpose of due diligence**

When it is conducted by the buyer due diligence is the process of investigating a company (the target) with the objective of helping that buyer make an informed decision regarding its proposed acquisition of, or its investment in, the target. It is usually undertaken simultaneously by a range of people on the bidder's transaction team, including business executives, accounting advisors, lawyers and financial advisors, each with their own area of expertise and focus.

The buyer's legal due diligence review usually examines the legal issues associated with the target. This might include looking at

the assets, liabilities, revenues and expenses that could affect the buyer's valuation of the target, or the drafting of the representations and warranties requested by the buyer in the acquisition agreement and/or the review of the seller's disclosure letter corresponding to these representations and warranties. Legal compliance requirements also need to be identified. These may be issues that could necessitate filings, consents or notices in connection with the transaction. The proposed structure of that transaction should also be analysed in light of these requirements. The results of the due diligence are then applied to the drafting and review of the transaction documents, including any disclosure letter prepared by the seller.

Although the buyer usually conducts due diligence on the target, there are circumstances where the target or its selling shareholders may wish to conduct due diligence as well. The target may want to undertake due diligence on itself prior to going to market in order to confirm the absence of any 'smoking gun' deal threatening legal issues, this is referred to as 'vendor due diligence'. If any issues do exist, the seller can manage them prior to engaging in negotiation.

The target may also wish to carry out due diligence in order to consider prospective bidder(s), particularly



# Mergers and acquisitions

## Dotting the I's continued from page 7

where there is contingent or deferred cash consideration or where consideration shares are to be issued. In addition, a target will want to develop an understanding of how the counterparty will behave during negotiation, i.e. will the commercial heads of terms be honoured?

The seller may need to undertake vendor due diligence in order to enable it to evaluate the representations and warranties requested by the buyer in the acquisition agreement and to prepare a disclosure letter corresponding to these representations and warranties. This is referred to as transaction risk allocation.

In the context of an auction sale with a large number of potential buyers, the seller will typically conduct vendor due diligence in order to drive the transaction timetable, thus reducing duplication of independent due diligence exercises by multiple potential buyers while making the target as attractive as possible to a potential buyer. In the context of auctions involving private equity houses, high quality preparatory vendor due diligence has become increasingly important in attracting finance.

### The data room

To enable prospective buyers to conduct due diligence, the seller and its legal advisors are called upon to help assemble and administer a data room. The data room is a single source for presenting legal and financial documents concerning the target's business for review by potential buyers. By centralising this presentation in the data room, the seller controls which elements of the target business potential buyers review in making their purchase decisions, the form and depth of their review, and the documents that are distributed. In recent years, data rooms have generally been hosted virtually on a secure web-based portal and accessed online, although where there is a substantial quantity of documentation, which would require scanning, physical data rooms still occur.

The management of information contained in a data room will be influenced by a number of factors, including: the nature of any deal and its proposed structure, how well organised the target's business and legal documentation is, whether the seller has an in-house legal team, where the data room is located and whether other advisors to the seller are involved. It is likely that a seller will want to limit information disclosed in the context of an auction sale, but this is less common in a negotiated transaction with a single buyer. A seller needs to come to a clear decision as to how much reliance it will place on advisors to assist with the data room preparation process.

The seller's legal advisors must work



## A well-prepared data room gives buyers confidence.

closely with the target's key stakeholders, in particular the board, the company secretary and management, and with other advisors. This will enable them to anticipate what documents potential buyers will want, to understand what relevant information exists, and to present documents the seller is willing to disclose in a comprehensive, concise and logical manner.

Careful organisation and a significant investment of time during the early stages of preparing a data room avoid many problems later in the process. The seller should anticipate the questions buyers may have and either include answers in the data room itself or structure the data room so as to eliminate any grounds for raising additional due diligence enquiries. A well-prepared data room gives potential buyers confidence in the seriousness and organisation of the target and helps facilitate a smooth, non-adversarial transaction process. In addition, good planning can reduce the duplication of work when preparing the disclosure letter later on.

### Room location

When considering the location of the data room, the seller should take into account various factors, such as: confidentiality, ease of access for potential and ease of

administration. To secure confidentiality, in particular in an auction context where target employees are usually informed of the potential sale only later in the process, it is often advisable to maintain the data room off-site, for instance at the offices of the seller's advisors. In some instances the location of potential buyers and the timing of the transaction make it desirable to run more than one identical data room simultaneously. If copying of the data room is necessary, it should be held off for as long as possible, in order to minimise the time spent adding updates and supplements to multiple data rooms at the same time. The use of virtual data rooms instead of physical, paper-based data rooms has become more common. They are particularly useful when the available timeframe for the transaction is tight or where potential buyers are spread over a wide geographical area.

### Public transactions

The extent to which it is possible to conduct buyer due diligence on a public transaction depends on whether the bid is hostile or recommended. If it is a recommended bid the process is similar to a private transactions, subject to certain particular requirements set out in the Takeover Code (the code). Due

diligence in the context of a hostile bid will be limited to publicly available information, and information that must be provided by the target under the Code or the Companies Act 2006. For instance, in relation to the target's share register, the register of disclosed interests (in response to a notice under section 793 of the Companies Act 2006), electronic addresses of target shareholders and certain other persons with information rights, and details of the target's share capital.

In addition, Rule 20.2 of the code requires that any information the target has provided to one bidder must, on request, be given equally to any other bidder, even if that other bidder is less welcome. This requirement only applies when there has been a public announcement of the existence of the bidder to which information has been given or, if there has been no public announcement, when the bidder requesting information under Rule 20.2 has been informed authoritatively of the existence of another potential bidder.

The code does not contain any restrictions on the conditions that the target may impose on a bidder before it agrees to pass information to it. However, once information has been provided to one bidder the target is required to provide the same information to other bidders under Rule 20.2 of the Code. The target is then very limited as to what conditions it may impose on the passing of that information to competing bidders. The only conditions the target may impose in such circumstances are:

- confidentiality;
- reasonable restrictions forbidding the use of the information passed to solicit customers or employees; and
- the use of the information solely in connection with a bid or potential bid.

### Results

The buyer team will often have follow-up questions, which the seller can answer by providing additional documentation, arranging for meetings with the seller's management and/or arranging for site visits. The results of the completed due diligence review are summarised in a series of reports prepared by the buyer's internal team and advisors. The legal due diligence report prepared by the bidder's legal advisors is addressed to the buyer and sometimes also to a third party, for instance, a bank providing acquisition finance.

The due diligence findings are reflected in the drafting of the representations and warranties in the acquisition agreement. On a standard sale to a single buyer, the first draft of the acquisition agreement is typically prepared by the buyer, whereas, in an auction context, the seller usually takes the lead in the drafting.

## The data room in practice

### Set up

Assembling a data room begins with a due diligence questionnaire, which constitutes a list of requests for certain documents to be gathered from the target for review. Typically, the seller will nominate an internal point of contact, who liaises with the relevant internal departments and the seller's legal advisors on any matters relating to the due diligence exercise.

The data room tracks the due diligence questionnaire, so that the questionnaire serves as the skeleton of a data room index. The appropriate level of detail for the index depends on the volume of documents and the time available. The more detailed the index, the easier it is to find documents and to guide potential buyers. A well-presented data room can reflect well on the company concerned, providing evidence of a well-managed business.

Depending on the volume of documents and time pressures involved, different levels of central review on behalf of the seller are appropriate. The bare minimum is a sweep through to remove mistakenly included documents, documents protected by confidentiality provisions and information protected by privilege, as well as to redact commercially-sensitive materials.

### Vendor's due diligence

This is carried out in order to: identify risk and value items before going to market and to allow for meaningful valuation assumptions to be made; to create an opportunity to rectify outstanding problems or to manage these issues in negotiation; and to

ensure that key information contained in an information memorandum is complete and accurate and aids the seller in drafting the acquisition agreement and the disclosure letter.

The substantive review by the seller resembles the due diligence review by the buyer, tracking change of control and assignment provisions, termination notice and consent requirements, expiration and renewal dates (for contracts, leases, licenses, permits), and exclusivity and non-compete provisions. The goal is to review what has been supplied and to identify missing materials, such as renewals to expired contracts, missing amendments, leases or deeds for all company properties and potential problems that may need to be included in the disclosure letter or otherwise resolved.

The data room should include everything that would appear in the disclosure letter so that buyer receives no surprises. When conducting a substantive review, the seller's key decision-makers will need to be in regular contact with the seller's advisory team to establish and confirm all relevant facts and materials.

### Managing the data room

Before opening the data room to potential buyers, the seller must establish appropriate rules and procedures, spelling out the hours of operation and the copying policy. The seller should consider whether the room should be supervised during the buyers' reviews and how it will monitor access. These policies will be prepared by the seller's legal advisors following discussions with the seller.

The seller should pay close attention to the drafting of the representations and warranties, as the buyer may have a claim for breach of contract if it later transpires that a warranted fact was untrue. However, the buyer will not have a claim if the seller previously disclosed the facts which give rise to the breach. The seller therefore should prepare a disclosure letter containing disclosures that correspond to the representations and warranties made to the buyer in the acquisition agreement. From the buyer's perspective, the disclosure letter is an important tool to verify its own legal due diligence. Absent extenuating circumstances, the disclosure letter should not reveal any information regarding the target that was not already known to the buyer.

Due diligence tends to be delegated to someone junior within each party's deal team. However, it is an extremely important part of the M&A process and one or two senior people should be involved if possible so that when facts come to light which require a decision by either buyer or target, the right person is able to take a view at the right time. Discovering an important fact late in the day, which has been known by juniors for a while, can be a deal-breaker. ■

### » About the author

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## The deep end

**Madeleine Cordes** talks to two senior company secretaries about their experiences of takeovers and mergers, the issues they faced and the lessons they learned.

**A**ndrea Thomas was involved in a number of takeovers of companies, both listed and otherwise, during her time with BP, and more recently in the acquisition of Axa by Friends Provident. The second company secretary was involved in a friendly merger of two UK listed groups in which a prospectus was required for both sets of shareholders.

### Starting off

As the actions got underway both company secretarial teams, which were very lean, had to burn a great deal of midnight oil on drafting an avalanche of documents. Not only that, at the same time they had to become part of the teams working with advisors to execute the transaction.

The other company secretary and her team spent a lot of time responding to requests for information – digging for, and then checking, the facts and figures in the transactional documents. This was necessary to be able to give a clear, continuous history of the development of both groups of companies.

During the transactions Andrea was involved in, her team was advising on UK company law matters, drafting board minutes and powers of attorney, and making continuous revisions to documents. They also had to ensure they had knowledge, and an understanding of, all the documents involved – reviewing the key items and, where appropriate, getting everything signed in advance or otherwise prepared for the closing meeting. In one of Andrea's acquisitions, although the legal side of deal was project managed by BP's external lawyers, there was considerable due diligence to be done at speed before the deal and her team took care of the company secretarial aspects.

The other company secretary's team tended to interact mainly with its internal colleagues such as tax and treasury, legal and finance. Of course they were in constant contact with the central merger team that leads the due diligence process – particularly because the secretarial team is responsible for ensuring that its progress is clearly minuted at board meetings, especially if

the acquiring company is regulated by the Financial Services Authority. A company secretary will also usually have contact with a member of the company secretarial team for the 'other side'. Where a listed entity is involved then, of course, there are a large number of external advisors in the loop, such as stockbrokers, lawyers and the public relations team.

### People issues

As a company secretary involved in a merger, a restructuring of the main board could well mean getting to know and work with a new chairman and chief executive who may have a different style to the previous incumbents and have different priorities. Subsidiary boards are also likely to be restructured as part of the merger, which will mean numerous filings and updates to registers. New directors without experience may be appointed and the company secretary can assist with training and education on the subsidiary corporate governance framework. In other company secretary's case, however, the major impact throughout the period of the merger was the uncertainty, at both companies, as to who would have a job at the end and who would not and that applied across both companies.

In Andrea's case, things were slightly different. She had to take over as line manager of the acquired company's company secretariat staff from day one following the closing of the deal, and then work out what should happen to the team. On the acquiring side's secretarial team, morale was good and people were excited. Because these were

large transactions, she took on competent interim staff to help, but always made sure that the permanent staff continued to take on interesting, challenging and career-enhancing work, to keep them motivated.

However, on the acquired-company side, morale amongst the staff was low. Andrea's policy was to meet and talk to each of the individuals separately on day one. She was as open as possible about BP's objectives in each case. That is to say that if the office was to be closed, the affected staff were told as soon as the deal was done so that discussions could take place about either redundancy, redeployment or relocation. Focusing on the individuals meant that they were able to make their own decisions and plans, which Andrea felt helped people feel a bit more in control. There were terminal bonuses on offer to encourage people to stay as long as they were needed. It was imperative for Andrea to quickly establish contacts all over the new business to secure some continuity once the deal was done and staff were let go. The remaining staff on the teams had weekly team meetings, video conferences and weekly visits so they could get to know each other and work together. These efforts meant that morale was better than it had been initially.

### Complexity

Initially, the other company secretary found herself left with two plc companies at the top of the structure, one with a number of dissentient shareholders. The plc was eventually re-registered as a private limited company and a project has been ongoing to rationalise the group structure, which has continued growing with various acquisitions. The other company secretary is still surprised

books which have not been updated prior to the acquisition. Often there is no company secretary or other contact left to be able to give the history, says the second company secretary, and it can be a real job to fill the gaps. There will also be importing and reconciliation of the records with your own corporate database to carry out, as well as audits and 'health checks', which are also advisable to verify the integrity of the

## It can be a real job to fill the gaps.

at how much time it takes to find out all the information you need to satisfy a liquidator, even when it is your own companies you are disposing of. There were some shareholders who never responded to the merger documents. Even more than 13 years later there are some who have never been traced. So there has had to be ongoing dialogue with the registrars to keep trying to trace the people and pay out the money held back for them.

### The aftermath

Following acquisitions involving groups of companies it is common to inherit statutory

information. This has to be a high priority job – the 'business as usual' tasks won't wait for anyone. After the takeover, but of course, things are always going to be difficult until redundancies have finished. ■

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# Taming the tiger



Many of the amendments proposed reflect the view that, in recent times, offerors have obtained a tactical advantage over the offeree company to the detriment of the offeree company and its shareholders. This disadvantage to the offeree arises as a result of the following:

- announcements of possible offers, which can have a destabilising effect on an offeree company;
- the length of the 'virtual bid' period (where a potential bidder makes an announcement that it is *considering* a possible offer for a target company, but does not have the support of the target to the bid);
- the ability of an offeror to engage directly with offeree company shareholders once an offer period has commenced;
- the comparatively small expense for an offeror to make an approach or a possible offer announcement (for example, the offeror does not need to have incurred financing costs) and, following such an approach or announcement, the offeree company is restrained from taking any action that might frustrate an offer;
- the reluctance of offeree company boards to ask for a 'put up or shut up' deadline (i.e. 'put up' a firm offer announcement, or 'shut up' and confirm no intention to bid); and
- the package of inducement measures (which include agreeing an inducement fee at the maximum permitted level) that offeree company boards are frequently required to enter into, which restricts their ability to engage with potential competing offerors in a way that is detrimental to the interests of offeree company shareholders.

It is proposed that the Code should be amended so as to:

- reduce the tactical advantage that hostile offerors have been able to obtain (a hostile offer is any offer not made with the support of the target); and
- improve the offer process and take more account of the position of those who are affected by takeovers (such as employees), in addition to offeree company shareholders.

The Code Committee will publish one or more further consultation papers setting out the proposed amendments to the Code. No

Does UK merger law favour predatory companies, and what is being done about it? **Ed Baker, Charles Mayo** and **Hannah Morley** examine the proposed changes.

**T**he Panel on Takeovers and Mergers is the regulatory body which administers the City Code on Takeovers and Mergers. The Code contains general principles and specific rules and guidance applicable to all offers and other transactions to which the Code applies, i.e. the conduct of UK public takeovers. The Panel's statutory functions are set out in and under Chapter 1 of Part 28 of the Companies Act 2006 – its central

objective is to ensure equality of treatment and opportunity for all shareholders in takeover bids.

#### Criticism

Significant changes to the Code are now being proposed by the Code Committee of the Takeover Panel. The changes derive from widespread criticism voiced from the media and industry following Kraft's controversial, but ultimately successful, bid for Cadbury.

indication as to the timing of these further consultations has been given, as yet.

### Main proposals

#### Timing

The first set of proposed amendments requiring potential offerors to clarify their position within a specified period of time. They would require that:

- following an approach, the offeror is named in the announcement which starts the offer period, regardless of which party makes the announcement; and
  - within four weeks of the date on which the offeror is publicly named, the offeror must (except with the Panel's agreement) announce a firm intention to make an offer; or
  - announce that it will not make an offer (and will then be subject to the restrictions on making further offers); or
  - apply jointly with the offeree company for an extension of the timetable and explain the proposed new timetable.

These amendments aim to avoid long periods of 'siege' for the offeree company and to give it some certainty as to how long the offer process will last. It will also discourage potential offerors from leaking their potential interest, and should go some way to more confidential discussions with the offeree company board which lead to an offer, hostile or otherwise, made in accordance with the established Code timetable.

It should be noted however, that these proposals would not apply where the offeree company board has initiated a formal public auction for the company.

#### Inducement fees

The second set of proposals prohibit deal protection measures and inducement fees other than in certain limited cases. They would prohibit all inducement fee agreements and

offeror company giving some inducement to an offer has been relatively widespread in recent years.

#### Information

The third set of proposals would require offerors to provide the same financial information and information about financing the offer regardless of the type of offer. As such, they would require:

- disclosure of detailed financial information on an offeror, in all offers, not just in securities exchange offers (currently a cash offer requires less information to be disclosed);
- where the offer is material, a pro forma balance sheet of the combined group will have to be included in the offer document, as well as details of the ratings attributed to the offeror by rating agencies (and any changes to those ratings that arise as a result of the offer);
- disclosure in greater detail of debt facilities or other instruments used to finance the offer; and
- all financing documentation to be put on display.

#### Employees

The proposals set out a number of new considerations in regard to employees. The first would, in general terms, require both the offeror and the offeree boards to set out their intentions for employees in greater detail.

Offerors will continue to disclose details of plans regarding the offeree company's employees, locations of business and fixed assets. It is proposed to introduce a requirement for a negative statement if there are no such plans. In addition, these statements (or the absence of any plans) will be expected to remain true for at least one year from the offer becoming or being declared wholly unconditional, unless another period is stated.

offeree company board's responsibility to publish the employee representative's opinion at the offeree company's expense, and to require the offeree company to pay costs incurred by employee representatives.

#### Fees

The proposals put forward would require public disclosure of all offer-related fees. Thus the Code would be amended to require:

- disclosure of the estimated aggregate fees for each party;
- separate disclosure of the estimated fees of each category of advisor to each party (including financial advisors, corporate brokers, accountants, lawyers and public relations advisors), including the minimum and maximum amounts payable as a result of any success, incentive or ratchet mechanism, but without revealing commercially sensitive information;
- disclosure of fees in respect of the financing provided; and
- any material change to these disclosed estimated fees must be announced promptly.

#### Considerations for the offeree

Finally, the code would be amended so as to clarify that offeree company boards are not limited in the factors they can take into account in giving their opinion and recommendation, and that it is not bound to consider the price as the determining factor.



The proposed amendments to the Code are wide ranging, and if implemented they will help offeree companies to defend themselves from unwelcome suitors. But will they cause the pendulum to swing too far in the favour of the offeree company? The requirement to disclose the identity of potential offerors and the prohibition on deal protection measures and inducement fees are likely to have a material impact. Whatever the final impact of the proposed changes may be, they are a timely reminder to company secretaries to have in place an up-to-date defence strategy (including a 'defence manual' if there is nothing already in place) and ensure that the board is aware of the current issues of public debate. ■

## The proposals will help companies defend themselves from unwelcome suitors.

any undertakings given to an offeror by the offeree company board to take any action to implement a transaction to which the Code applies, or to refrain from taking any action that might facilitate a competitive transaction. The prohibition would not, however, apply where the offeree company board has initiated a formal public auction for the company.

This proposal has caused considerable debate not least because the practice of an

Also proposed are measures to improve the ability of employee representatives to make their views known. The Code will be amended to make it clear that the rules do not prevent the passing of non-public information to employee representatives, and to require offeree company boards to inform employee representatives of their rights (under the Code) to circulate an opinion. Other changes to the Code will make it clear that it is the

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# Cutting back



**John Rowland-Jones** looks at how to rationalise a company's structure in the wake of a corporate action.

Ideally, when acquiring a group of companies, the due diligence process should identify the key companies within the target. In theory, only those key companies would then be acquired, leaving the others behind. However, this does not always happen – often entire groups of companies are acquired, whether wanted or not, leading to unwieldy corporate structures. Awkward structures can also be the result of evolution, through organic growth.

However the company structure develops, a typical group structure is a number of core trading entities clouded by a large number of dormant entities. This can lead to structures that are overly-complex and difficult to manage. This then leads to cost inefficiencies – unnecessary company administration can quickly mount up, especially for those groups that are very acquisitive.

Although there is a relatively immediate way for these types of groups to cut away the number of unnecessary companies, which I will describe shortly, it is advisable instead to proactively manage the issue. As I mentioned initially, by having an acquisition process that acts in a 'gatekeeper capacity' and does not allow in unwanted companies the problem can mostly be prevented.

The Capita Group has, through its M&A activity, focused on refining the acquisition process. Francesca Todd, Deputy Group Company Secretary, recently commented: 'With a very acquisitive group like Capita it is extremely important for us to limit the take on of unnecessary companies as much as possible. In addition, at take on we include steps to help with the ongoing administration such as adopting standard articles and streamlining share capitals.'

## **Rationalisation**

However you choose to manage the issue, it is recommended that all companies frequently review their structures and take action to restructure and streamline them. More and more groups have seen the benefits of undertaking rationalisation programmes, and here I outline the basic steps required in such a process.

## **Approach**

Thought should be given to the precise format of the programme. This can be critical, as the key to any successful rationalisation exercise is gaining positive engagement from key stakeholders. Therefore the format should be focused

and minimise the disruption to stakeholders and the business as a whole. For constantly evolving groups, a rolling format that examines different parts of the group in turn would be recommended. This approach would spread the actions generated by the programme throughout the year, avoiding a tidal wave of activity. It would also focus stakeholders' engagement in the process by keeping it 'front-of-mind' at all times.

Alternatively, for more static groups, a one-off format could be used. In this model groups of companies are prioritised according to the complexity of the issues which need to be resolved and other features. This is a more resource-hungry approach, but it benefits in having a short, sharp impact on the business.

Once the format of programme is chosen the next step is to carry out due diligence on the target companies. This allows you to understand their current position and agree the actions to be taken.

## **Due diligence**

One of the major challenges with any rationalisation programme is information (or lack of it). This is especially the case in a takeover situation where the staff that had knowledge of the companies may no longer be employed by either of the companies. It is the classic case of having to consider the 'known-knowns', 'known-unknowns' and 'unknown-unknowns'.

A thorough due diligence process is key

– as much historic and current information as possible should be collated on the target companies. Importantly, relevant key personnel (stakeholders) must be included to catch and document any important tacit knowledge. The process could be managed through the completion of detailed checklists which cover areas within the business. One such split could be property, finance, insurance, pensions, staff, legal and company secretarial. Once a complete picture of the company's status has been created, only then actions can be agreed.

#### Actions

There are three kinds of actions: restructuring, preparing for dissolution and dissolution. A step plan is a good way to document and track the agreed action and ensure that everything flows smoothly.

#### Restructuring actions:

- inter-group share transfers to move companies within the group;
- business transfers, moving a business from one entity to consolidate business in a second entity; and
- novation agreements (the replacing of an obligation or party) to transfer out any legacy assets (and sometimes liabilities) to another entity within the structure.

#### Actions to prepare for dissolution by strike-off:

- 'debt waivers' to document the forgiving of any inter-company debts to clear down an entity's balance sheet;
- 'reduction of capital by solvency statement' to reduce a company's share capital and release reserves so that the funds can be fed upstream by way of dividend; and
- dividends to clear down distributable reserves.

#### Dissolution actions:

- dissolve the company by way of strike-off; or
- dissolve the company by way of liquidation.

#### Detail

Some of these actions are key, so they are worth describing in a little more detail.

#### Reduction of capital

The introduction of the ability to perform a reduction of capital by way of solvency statement under Section 642 of the Companies Act 2006 has been a boon to groups undertaking rationalisation programmes. Whereas in the past an entity has had to be liquidated due to having significant reserves, the new process, in some cases, provides a simple way to reduce those reserves and subsequently allow the entity to opt for the less expensive option of dissolution by strike-off.

The common reserves that can be reduced in this way are the issued share capital and share premium. To begin the process, a solvency statement, signed by all the directors of the entity and prepared pursuant to S.643, the Act is circulated to the shareholders for approval. Once approved, the solvency statement, plus a copy of the supporting resolution, a Companies House Form SH19 (statement of capital) and a compliance statement, confirming to the Registrar of Companies that all necessary steps have been adhered to, need to be filed within 14 days of

The process is commenced by all, or a majority of, the directors making a statutory declaration of solvency. They will need to have formed this opinion after having made a full enquiry into the target company's affairs and are able to confirm that the company will be able to pay all its liabilities (plus any interest due) within a period not exceeding 12 months. Following this the company, supported by shareholder resolutions, is placed into liquidation and a licensed liquidator is appointed. The liquidator has additional powers open to

## Proactive prevention is quicker and more cost-effective.

the passing of the resolution. The reduction does not take effect until it is registered at Companies House. This can be priority processed, with Companies House making a charge for this service.

#### Strike-off

The strike-off process may be used for entities where the level of information and knowledge about the entity is high (the 'known-knowns' category). The value of the assets on the balance sheet should be very low as, although the Crown Solicitor has historically not sought to assert the Crown's right over the assets which would be deemed '*bona vacantia*' (ownerless goods) under the striking off process, this right could in theory be exercised. Clearing the balance sheet can in most cases be achieved via the steps listed above.

Strike-offs are inexpensive, straightforward and relatively fast to process. The entity's directors apply to Companies House using a Form DS01 requesting the Registrar of Companies to consider striking the company from the public register. Once this is accepted, Companies House will promptly publish a notice in the Gazette advertising the application. Subject to no objections being lodged, the Registrar will then publish a further notice after three months have elapsed. Once this is published the entity is removed from the public register.

#### Liquidation

Solvent liquidation (otherwise known as 'members' voluntary liquidation') would particularly be considered for companies that fall into the 'unknown-unknown' or higher-risk category, due to retained information within the group being incomplete. These would typically be entities that have in the past undertaken insurance or pension activities.

him that would be unavailable to directors, such as dealing with creditors and requiring creditors to prove their claims within a set period of time. Once the liquidator has arranged the final meeting of the company and the appropriate resolutions have been filed with Companies House, the company will be dissolved after three months.

■ ■ ■

As you have seen, while there are many ways to simplify the structure of a company, your choices really depend on the level of information known about an entity and the risk appetite of the directors concerned. If the level of information is good the steps above would be used to consolidate businesses, reduce capitals, waive debts and dividend up surplus funds. Then the empty, dormant entities would be either held for future use or an application made to Companies House for strike-off. When consolidating, however, consideration should also be given to any unwanted pooling of liabilities and risk. If, however, the level of information is low and/or the target company was previously involved in significant transactions within higher risk industries, consideration should be given to liquidating the entities.

Whichever methods you choose, rationalisation programmes are complex and can require a great deal of time and resource to deliver their goals. Therefore, if they can be avoided, so much the better. Proactive prevention is quicker and more cost-effective, so the golden rule for unwanted companies is: don't let them in! ■

#### » About the author

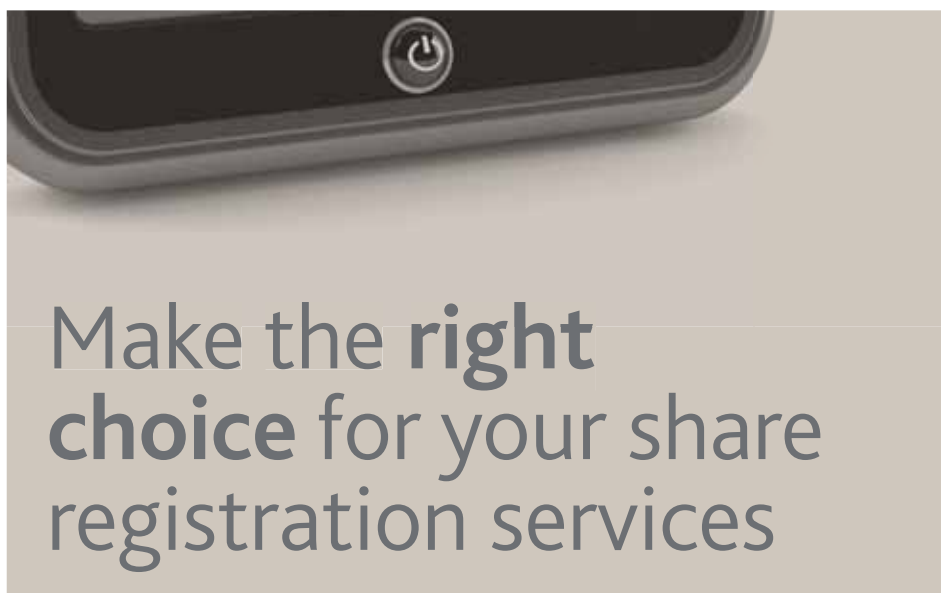
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