**Stakebuilding**

This element looks at the rules which govern stakebuilding under the Takeover Code.

**What is stakebuilding?**

‘Stakebuilding’ is the expression used to describe a bidder (or potential bidder)’s purchase of shares in the target prior to or during a takeover. A bidder, particularly in a hostile takeover situation, may choose to purchase shares in the target company in order to increase the likelihood of success of its bid.

Stakebuilding can occur during an offer as well as beforehand – a bidder in an offer may continue buying shares on the market after making their offer, which may have the effect of consolidating their interest in the company and encouraging other shareholders to accept the offer.

The rules governing stakebuilding apply to a takeover, regardless of the structure which the bidder plans to pursue.

**Key advantages of stakebuilding**

* The bidder can buy shares at the market price (if buying prior to the announcement of the takeover) which may be below the offer price.
* In a contractual offer, stakebuilding may increase the likelihood that the bidder will obtain over 50% (and, therefore, gain control) of the target company. This is because all shares held by the bidder in the target count towards the Rule 10 50% + 1 threshold.
* Stakebuilding may also mean that potential rival bidders are ‘shut out’, in that they either have no opportunity to buy a substantial stake or that the first bidder has acquired such a large stake that the risk of an unsuccessful bid or troublesome minority shareholder is too high for the potential rival to contemplate.
* If a bidder builds up a stake in the target at a good price but loses out to a higher competing bid, it can accept that higher bid and sell its shares at a higher price, thereby providing an element of downside protection.

**Key disadvantages of stakebuilding**

* The bidder’s purchases may alert the market to a potential bid for the target, causing the market price of the target’s shares to increase; this may put pressure on the bidder to set a higher price in its takeover.
* In a contractual offer, if a bidder is seeking to achieve 100% ownership of the target, pre-offer stakebuilding will not assist it in reaching the threshold required to compulsorily acquire the remaining shares (and it may make it harder). Any shares held by the bidder before it makes its offer will not count towards the 90% threshold.
* A scheme of arrangement can be passed by a majority in number of those holding 75% in value of the votes of those present and voting at the meeting (s.899 CA 06). This is discussed further in the next workshop. At the Court Meeting, the target company must obtain approval for each class separately. However, **any shares held by the bidder or persons connected with the bidder are excluded** from voting with the other ordinary shareholders (Re Hellenic & General Trust Ltd). Therefore, any voting rights attached to the shares held by the bidder will not count.
* Stakebuilding may set a floor on the minimum terms of a future or current offer (see Rules 6 and 11 of the Takeover Code).
* A bidder could be left with a stake that it does not want following an unsuccessful bid.

**Rules 6 and 11: effect of acquiring interests up to 30% before and during the offer**

Where stakebuilding results in a bidder holding an interest of less than 30% in the target company’s shares, Rules 6 and 11 govern the impact of that transaction on the terms of the bidder’s takeover. Depending on the facts and the timing, the effect of Rule 6 and/or 11 may be to:

* provide minimum terms on which the bidder can make its future bid; or
* require the bidder to revise the terms of a bid it has already made.

Note that, where the acquisition gives rise to an obligation under Rule 11 (see below), compliance with Rule 11 will normally be regarded as satisfying any obligation arising under Rule 6.

**Rule 6**

Where a bidder or any person acting in concert with it has acquired an interest in any shares in the target company:

* within the 3 months preceding the start of an offer period (Rule 6.1(a)(i)); or
* during the period, if any, between the start of an offer period and the formal announcement of a bid under Rule 2.7 (Rule 6.1(a)(ii)); or
* after a Rule 2.7 announcement but before the offer closes for acceptance (Rule 6.2),

the offer to shareholders must not be on less favourable terms than the acquisition (Rule 6.1 and Rule 6.2).

**Rule 11.1**

Rule 11.1 applies where shares are acquired by the bidder for cash. In reality, where the bidder is stakebuilding by buying shares on market, it would be most unusual for the shares to be acquired for consideration other than cash.

Rule 11.1 is split into two parts:

* Rule 11.1(b), which is triggered by any purchase of target shares during the offer period; and
* Rule 11.1(a), which can be triggered by any acquisition during the offer period or in the previous 12 months but only if the bidder acquires interests in target shares representing 10% or more in aggregate.

**Rule 11.1(b)**

If the bidder or any person acting in concert with the bidder acquires for cash an interest in any shares in the target company during the offer period, any offer must be in cash or accompanied by a cash alternative at not less than the highest price paid by the bidder during the offer period.

In this context, the obligation to provide a ‘cash alternative’ means that the bidder may offer non-cash consideration (e.g. bidder shares or loan notes) but it must provide target shareholders with the option to receive consideration cash instead.

**Rule 11.1(a)**

If the bidder or any person acting in concert with the bidder acquires for cash an interest in shares in the target company carrying 10% or more of the voting rights of the company within 12 months prior to the start of an offer period and/or during the offer period itself, then the offer must be in cash or accompanied by a cash alternative (see above) at not less than the highest price paid by the bidder during the offer period and within 12 months prior to its commencement.

Please note that the acquisition of 10% or more of the target’s shares can be in one acquisition or in a series of acquisitions, provided that that 10% threshold was acquired within the relevant period (i.e. during the offer period and the 12 months prior to the start of the offer period).

Note that Rule 11.1(b) is expressed to be subject to Rule 11.1(a) so a bidder should comply with Rule 11.1(a), rather than Rule 11.1(b), if both apply.

**Commencement of the offer period**

It is important to understand when the offer period commences in order to be able to apply these stakebuilding rules. As set out in the Definitions section of the Takeover Code, ‘an offer period will commence when the first announcement is made of an offer or possible offer for a company, or when certain other announcements are made, such as an announcement that a purchaser is being sought for an interest in shares carrying 30% or more......’. An offer period will end when an announcement is made that an offer has become or has been declared unconditional, that a scheme has become effective, or that all announced offers have been withdrawn or lapsed or following certain other announcements having been made….’.

**Effect of acquiring an interest in 30% or more**

If the stakebuilding in question leaves the bidder with an interest of 30% or more in the target, Rules 5 and 9 will apply and Rules 6 and 11 can be disregarded.

See the element entitled Mandatory Offers for further detail on Rules 5 and 9.

**Concert parties**

Rules 5, 6, 8, 9 and 11 all refer to persons ‘acting in concert’ with the bidder. The Takeover Code provides a definition of such persons in the Definitions section: ‘persons who, pursuant to an agreement or understanding (whether formal or informal), co-operate to obtain or consolidate control…of a company…’. Certain persons are presumed to be concert parties of a bidder company, including its directors, its other group companies and its ‘connected advisers’ (e.g. a party’s financial adviser).

This is an important definition because, as indicated above:

* the interests of all concert parties will be aggregated with those of the bidder to determine whether or not the bidder must make a mandatory offer for a target (having passed the 30% threshold); and
* if any concert party has acquired an interest in shares in the target, that acquisition by the concert party may affect the price which the bidder has to offer to shareholders.

**Summary of stakebuilding provisions (1)**

Interest

Any amount during the 3 months prior to the offer period

Obligations

If the acquisition is within 3 months before an offer period, then any takeover offer must not be made on terms less favourable than the acquisition.

Rules

Rule 6

**Summary of stakebuilding provisions (2)**

Interest

Any amount at the start of or during the offer period

Obligations

Any offer must be on terms no less favourable than the acquisition.

Interests of the bidder and target in shares of the target (and in shares of the bidder, unless the bidder is offering only cash) must be disclosed in an Opening Position Disclosure. Subsequent dealings must also be disclosed in a Public Dealing Disclosure. (Rule 8 disclosures are addressed in the next element)

If shares purchased for cash by the bidder or a person acting in concert, the offer must be in cash or accompanied by a cash alternative.

Rules

Rule 6

Rule 8

Rule 11.1(b)

**Summary of stakebuilding provisions (3)**

Interest

1% or more

Obligations

Any other holder of shares in the target or of shares in the bidder (unless the bidder is offering only cash) must make an Opening Position Disclosure at the start of the offer period and/or subsequently a Dealing Disclosure if purchase of further shares is made during an offer period.

Rules

Rule 8

**Summary of stakebuilding provisions (4)**

**Interest**

3% or more

Obligations

Disclosure by shareholder to the company of changes in voting rights held over 3%, leading to RIS announcement by the company.

Rules

DTR 5

**Interest**

10 % or more

Obligations

If 10% or more acquired for cash in the 12 months prior to the start of and/or during the offer period, any offer must be in cash or accompanied by a cash alternative. Note that this level can be reached by aggregating acquisitions.

Rules

Rule 11.1(a)

**Summary of stakebuilding provisions (5)**

**Interest**

30% or more

Obligations

Prohibited, subject to exceptions. If permitted by Rule 5, may be a requirement to make an offer for the whole of target on terms set out in the Takeover Code.

Rules

Rule 5

Rule 9

**Interest**

More than 50%

Obligations

Offer capable of becoming unconditional.

Any mandatory offer would need to be unconditional.

Takeover Code stakebuilding provisions cease to apply.

Rules

Rule 9

Rule 10

**Summary of stakebuilding provisions (6)**

**Interest**

90% or more

Obligations

Minority shareholders entitled to have their shares bought out by the bidder.

If 90% of the shares to which the offer relates have been acquired, bidder entitled to compulsorily purchase minority shareholders.

Rules

s. 979 CA 06

s. 983 CA 06

NOTES:

* For the purposes of the Takeover Code, all calculations of share capital exclude treasury shares.
* Also note (though the detail is beyond the scope of the module) that the percentages shown above may not be limited to direct or indirect holdings of shares, but in some cases also include certain financial instruments.
* A disclosure under DTR 5 is also required if an existing holder of 3% increases its holding so that it crosses a further percentage point threshold.

**Summary**

* Stakebuilding is the expression used where the bidder (or potential bidder) purchases shares in the target prior to or during the offer.
* Advantages include the ability for the bidder to increase its chance of accumulating over 50% of the shares in the target and being able to take control. This may shut out other potential bidders.
* Disadvantages include alerting the market to the bidder’s intentions.
* Where a bidder acquires shares in the target which amount to less than 30%, Rules 6 and 11 may apply. The effect of these rules is to set a floor for the consideration which the bidder may offer in an eventual offer and may tie the bidder to offering cash (or a cash alternative).
* Where the bidder acquires 30% of more of the target, Rules 5 and 9 will apply.
* It is crucial to understand the concept of concert parties when apply these rules.