**Planning a takeover bid**

This element provides an introduction to different types of offer before examining considerations for a bidder when planning a takeover bid.

**Types of bid: recommended**

A recommended bid is an offer where the directors of a target board have recommended to the target’s shareholders that they accept the offeror’s bid. The target shareholders still make the decision whether or not to accept. However, the bidder has a significant advantage if an offer is recommended, since target shareholders are usually influenced by their board’s recommendation.

Additionally, in a recommended bid situation, the bidder has more access to the management, documents and records of the target, all of which reduces the risk inherent in the bid from the bidder’s point of view. A potential bidder who wants to make a recommended bid will first approach the board of the target on an informal basis to negotiate the terms of the offer. The target board may provide the bidder with information about the target company to assist the bidder with its due diligence and pricing of the bid. In some cases, the target company directors may have put the target company ‘up for sale’ i.e. approached potential bidders and asked them to make a bid. This might take the form of a ‘formal sale process’ (as defined in the Takeover Code) or a more informal sale process.

A recommended bid does not always stay recommended throughout the offer process. For example, if another bidder makes a competing offer, the target company directors may switch their recommendation to the later bidder.

**Types of bid: hostile**

Not all approaches to target boards result in recommended bids. If the target board is not prepared to engage in discussions with a potential bidder, the bidder may decide to launch a hostile (i.e. unrecommended) bid. Alternatively, a bidder may tactically decide to launch a hostile bid from the outset if it is confident that the target shareholders will be receptive. This has an element of surprise for the target company board.

Hostile bids are much less common than recommended bids.  Two key reasons for this are:

1. they entail considerably more risk for the bidder (which will not have had access to due diligence documents outside the public domain); and
2. the target shareholders will usually require much more persuasion to accept a hostile offer (when compared to a recommended offer which is backed by the company’s board).

A scheme of arrangement is not a suitable structure for a hostile bid as it requires extensive cooperation from the target board (see the element Introduction to schemes of arrangement).

Just as a recommended offer may later become hostile, a hostile offer may subsequently be recommended by the target board e.g. if market circumstances have changed, the price offered is increased or if the bidder has gained notional control of the target company.

**Types of bid: competitive / competing offers**

A competitive/ competing (or contested) offer is where there is more than one bidder competing for a target company. The target company board may have recommended one of the bidders’ offers; the other bid or bids will be hostile. Alternatively, all of the bids may be hostile.

Competitive bids are fairly rare. They tend to occur when one bidder has made an offer for a company and other potential bidders recognise that this is a good opportunity. The subsequent bidder may be a competitor of the first bidder and want to prevent it gaining a competitive advantage.

Competitive bids have a significant impact on the takeover timetable.

**Planning the bid: early considerations**

In the period before the bidder makes an announcement of its firm intention to make an offer, it is essential that the existence and details of the takeover are kept secret to avoid any obligation to announce the offer prematurely under the Takeover Code (see Rule 2.2).

During this period, the bidder will put together its team of advisers, including investment bankers, brokers, lawyers and accountants and appoint a committee of the board of directors to take the day-to-day decisions relating to the takeover.

**Planning the bid: type and structure**

Will the takeover be recommended or hostile? Is the target company board likely to recommend the takeover? Is it worthwhile for the bidder to negotiate with the target board or should the bidder simply launch a hostile takeover with the advantage of surprise? (Note that this last option is rare in practice: it is a high risk strategy for the bidder and may be counterproductive for the bidder’s relationship with the target shareholders.)

Does a new company need to be set up to launch the bid? If the bidder is hoping to secure a recommendation from the target board, should the bid be structured as a scheme of arrangement?

The potential bidder should consider the pros and cons of buying target shares in the market at this stage (known as ‘**stakebuilding**’).

**Planning the bid: price and consideration**

What price will be offered to the target company shareholders for their shares? Will the consideration be cash, shares in the bidder, loan notes or a mixture of these alternatives?

**Cash**

This is included in many offers as it is very persuasive to target shareholders. It has certain value and does not dilute existing members’ shareholdings in the bidder. Note that Rules 6 and 11 of the Takeover Code may require an offer of cash or a cash alternative to be made in given circumstances, as well as requiring the bidder to offer a minimum level of cash consideration.

**Shares**

Where the bidder’s shares are traded on a market, it will sometimes offer shares in itself to target shareholders as payment in exchange for their shares in the target. This may be because the bidder does not have sufficient cash or does not want to borrow the money. Offering shares in the bidder as consideration can help to present the bid as a merger of equals and a chance for target shareholders to participate in the success of the enlarged group. From the target shareholders’ perspective, shares represent an asset which should provide income (i.e. dividends) and may increase in capital value over time but many target shareholders prefer the certainty of cash.

Tax is potentially payable by the target shareholders on the sale of their shares to the bidder as the sale amounts to a disposal of a chargeable asset (subject to CGT in the hands of individuals and corporation tax for companies). If the target shareholders receive shares in the bidder, their tax liability is deferred until they subsequently dispose of the shares in the bidder.

If the bidder is a listed company, the listing of the new bidder shares will need to be a condition of the takeover bid. The bidder will be obliged to follow the procedures for obtaining a listing set out in the UKLRs and PRRs, and the bidder may be required to produce a prospectus in respect of the new bidder shares. Under the PRRs, an exemption exists in the context of a takeover which may allow bidders to choose to produce ‘an exemption document’ rather than a prospectus in the context of a takeover; or a prospectus may not be required if the takeover is being implemented by way of a scheme of arrangement.

Note that, if the bidder is listed in another jurisdiction, it will need to comply with the local law and regulation in relation to the issue of consideration shares.

**Loan notes**

These can be offered to target shareholders as an alternative to cash for tax reasons.

If the target shareholders receive loan notes, a tax liability arises when the loan notes are redeemed by the target shareholders for cash. They can be redeemed over a number of years enabling target shareholders who are individuals to take advantage of more than one annual CGT exemption, thereby reducing the amount of CGT payable overall (or extinguishing any liability completely). These loan notes are usually made non-transferable to ensure that they do not fall within the definition of ‘transferable security’ in s.102A FSMA (which would require a prospectus to be produced).

**Mixture of consideration**

A bidder will often combine different forms of consideration in an offer to the target shareholders.

If the bidder will be seeking a recommendation from the target board, it will need to negotiate the price with the directors. If it will be a hostile offer, the bidder will have to judge, with the advice of its financial advisers and brokers, what price it needs to offer the shareholders to entice them into accepting the offer.

**Planning the bid: special deals for management?**

Some takeover bids involve the bidder coordinating with the management of the target company in a management buyout (or ‘**MBO’**).

In practice, in an MBO situation, the position which the members of management will be in after completion of the takeover will differ from the position of all other shareholders. Given the importance of equality of treatment under the Code (see GP1(1)), Rule 16 contains detailed rules which apply in an MBO situation.

* Special deals with shareholders may only be granted with Panel consent.
* Where management incentivisation arrangements are envisaged, the target’s financial adviser must give its opinion that they are fair and reasonable.
* If the incentivisation arrangements are of significant value or unusual in nature, the Panel’s consent must be sought.
* In certain circumstances, independent target shareholder approval will be required.

**Planning the bid: regulatory issues?**

**Prospectus or exemption document?**If the bidder is a UK listed company, are there any implications arising from the provisions of the LPDT Rules? For example, a prospectus or exemption document may be required if shares in the bidder are offered as consideration or on a mix-and-match offer where shareholders are given the opportunity to elect for cash or a shares or a ratio of each.

An exemption document may be used instead of a prospectus under the exemptions in PRR 1.2.3/Art.1(4)(f) and (g) and PRR 1.2.4/Arts.1(5)(f) and (g), UK Prospectus Regulation. However, note that it is very rare for the parties to rely on an exemption document.

Where a bidder is effecting its takeover by way of scheme of arrangement, it may not be required to issue a prospectus (or an exemption document), even if shares are being offered as part of the consideration. This is because, although there is a shareholder vote on the scheme, shareholders do not generally make an individual choice as to whether to subscribe for shares. However, if the bidder is admitting more than 20% of its issued share capital to trading, it will likely need to produce a prospectus as it will not benefit from the exemption in PRR 1.2.4/Arts 1(5)(a) UK Prospectus Regulation.

**Shareholder approvals and/or competition clearances?**  
The transaction may also require approval of the bidder’s shareholders. Are there any relevant sector-specific regulations?

What is the likelihood of the takeover being challenged by competition authorities? Any such challenge would lead to delay and could lead to the takeover being blocked or conditions being imposed on the bidder (e.g. an obligation to sell off part of the merged business) if the takeover is deemed anti-competitive.

**National Security and Investment Act 2021 (‘NSI Act’)**  
A takeover of a company in certain high risk sectors is notifiable to the Secretary of State under the NSI Act and the parties must obtain the Secretary of State’s authorisation and approval to proceed. Transactions in other sectors may also be subject to this regime if it is considered that they could give rise to a risk to national security. Depending on the jurisdiction of the parties, equivalent provisions in other jurisdictions may apply to the transaction.

**Planning the bid: how much due diligence?**

Due diligence is the process undertaken by a bidder to find out relevant information on the target company. The bidder will want to discover what the target’s business is worth (and therefore how much to offer the target’s shareholders) and whether there are any hidden liabilities/problems in the business. All substantive due diligence should be complete by the time the bidder makes its firm intention announcement.

**Recommended bid**The bidder can send a detailed request to the board of the target asking for information on the target, e.g. key financial information, key contracts, key customers. The information provided by the target will be much less extensive than on a private acquisition because much more information relating to a plc (particularly a listed one) will already be in the public domain (annual reports, RIS announcements etc.).  
**Hostile bid**

The bidder usually only has access to public sources of information, such as that held at Companies House (constitutional documents, accounts, etc.), announcements made to an RIS and information published on the target company’s website.

The due diligence is therefore much less extensive on a hostile bid than on a recommended bid and, as a result, there is a greater risk that the bidder will fail to unearth hidden problems or liabilities (although where the target is listed and subject to UK MAR, it should have announced any inside information about itself to the market).

**Competing offers**  
The target company should be aware of Rule 21.3: ‘The board of the offeree company must, on request, equally and promptly provide an offeror or bona fide potential offeror with all information that it has provided, and that it provides in the seven days following the request, to another offeror or potential offeror’.

Therefore, a target board must be careful about what information it provides to a ‘friendly’ bidder, as it may be required to provide a subsequent hostile bidder with the same information. This will be of particular concern if the bidder is a market competitor of the target.

**Planning the bid: secrecy and confidentiality**

Rule 2.1: ‘Prior to the announcement of an offer or possible offer, all persons privy to confidential information, and particularly price-sensitive information, concerning the offer or possible offer must treat that information as secret and may only pass it to another person if it is necessary to do so and if that person is made aware of the need for secrecy.’

Secrecy is essential to avoid an inequality of information in the market which could lead to speculation, insider dealing or market abuse and to avoid an announcement being required under Rule 2 of the Takeover Code before the bidder is ready to make a firm intention announcement.

To ensure a potential bid is kept secret, information about the bid should only be disseminated to those who need to know e.g. the relevant company’s directors and advisers. All recipients should also be made aware of their duty of confidentiality and it is common practice to require recipients (other than advisers) to sign a confidentiality agreement. The potential bid will usually be given a code name. Even within the advising law firms, solicitors dealing with the matter will not discuss it outside of the project team.

**Planning the bid: co-operation agreements**

On recommended bids, the bidder and target company often enter into ‘co-operation agreements’ which set out certain respective obligations in connection with the implementation of the bid. These usually include provisions pursuant to which the parties agree to co-operate in relation to obtaining regulatory clearances and to address certain employment matters such as insurance and employee share schemes.

**Planning the bid: irrevocable undertakings and letters of intent**

To reduce the risk of the bid failing, the bidder may seek undertakings from major shareholders and directors of the target company that, in respect of their own shares, they will accept the offer.

Irrevocable undertakings can be: ‘hard’ i.e. binding in all circumstances; ‘soft’ whereby the shareholder may withdraw if e.g. another party makes a higher offer; or ‘semi-hard’ whereby the undertaking ceases to be binding if a higher offer emerges which exceeds the existing offer by an agreed amount. Letters of intent, as the name suggests, are less strong but may nevertheless assist the success of the transaction.

Irrevocable undertakings and letters of intent act as a sign of commitment by the target’s major shareholders and directors to the bidder and may influence the decision of other target shareholders on whether to accept the bid. Negotiation of the irrevocable undertakings may also give the target’s major shareholders the opportunity to discuss with the bidder the offer terms which they would consider acceptable (if the terms which are currently being offered are not acceptable).

For the avoidance of doubt, irrevocable undertakings and letters of intent, provided that they simply require the shareholder to accept the offer when made, are not considered to be ‘offer-related arrangements’ and therefore do not fall foul of Rule 21.2.

It is standard market practice for the bidder to approach major shareholders with a view to obtaining irrevocable undertakings or letters of intent in the last few days before the firm intention announcement is made in order to minimise the risk of a leak.

In practice, if a bidder can accumulate 20% hard irrevocables in support of its bid, this will generally prevent a competing bidder from succeeding with a scheme of arrangement.

**Summary**

* Offers can be recommended or hostile; they are occasionally contested (competitive).
* Confidentiality is critical in the early stages of a takeover to avoid the need to make an announcement to the market before the parties are ready.
* The key types of consideration in a takeover are cash, loan notes and shares in the bidder; it is also possible to offer a mixture of consideration.
* Regulatory issues such as the need for a prospectus or to seek CMA clearance may have a significant impact on the deal timetable and, potentially, its likelihood of success.
* The type of bid will determine how much due diligence access the bidder will be afforded: this is one of the main reasons why hostile takeovers are riskier for the bidder.
* Co-operation agreements and irrevocable undertakings are regularly entered into by parties trying to enhance their chance of a successful transaction.