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Gray Zone: When a UK-Incorporated Company Is Protected by Neither the UK Takeover Code nor US Law

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This article is from Skadden's *2024 Insights*.

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Key Points

- U.K.-incorporated companies may assume that they are protected by the Takeover Code's rules on bids and other changes of control, but that is not always true if they are listed in the U.S.
- Whether or not the Takeover Code applies can change with the composition of a company's board or other factors. When it does not apply, a company will generally not be protected by U.S. rules governing takeover bids in the same way the company would have been protected by the Code.
- It is vital for U.K.-incorporated companies that are listed in the U.S. as foreign private issuers to monitor their Takeover Code status. They may want to revise their organizational documents to incorporate some of the Takeover Code's protections there.

The U.K. City Code on Takeovers and Mergers (Takeover Code) is designed to ensure that shareholders in public companies are treated fairly and equally when there is an acquisition or consolidation of control, and to provide an orderly framework within which takeovers are conducted.

The Takeover Code provides protections for both (i) companies, against coercive or creeping acquisitions of control (*e.g.*, by forcing a mandatory tender offer upon reaching a 30% shareholding) and prolonged siege in a bid scenario, and (ii) shareholders, where there is a potential change of control, by ensuring that they have sufficient time and information to consider the merits of a bid and that its terms are equivalent for all shareholders.

However, in some circumstances where a U.K.-incorporated company has its primary or only listing in the U.S. as a foreign private issuer (FPI), the Takeover Code's protections may not apply, and federal and state laws in the U.S. also may not protect the company or shareholders in the event of a hostile or speculative bid. Moreover, the Takeover Code may apply to such a company at some points but not others, depending on events at the company, including changes in the composition of its board.

U.K. FPIs, their boards and their shareholders therefore can find themselves in a gray zone where it is uncertain what legal framework applies to a bid. This creates the potential for prolonged siege, a risk that the company will not be prepared and a possibility that a hostile bidder may have a strategic advantage.

To prevent this type of situation from arising, U.K. FPIs should closely monitor the applicability of the Takeover Code on an ongoing basis and consider amending their organizational documents to implement any desirable bid protections there.

Jurisdiction and Applicability of the Takeover Code

Public companies incorporated in the U.K., the Channel Islands or the Isle of Man (each, a Code Jurisdiction) that maintain a U.S. listing as an FPI under

U.S. securities laws (U.K. FPIs) are likely to first consider and disclose Takeover Code applicability upon listing. However, in some cases, the Takeover Code will not apply, leaving the U.K. FPI without its protections and without the defenses available to U.S.-incorporated companies.

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The Takeover Code applies to any public company that has its registered office in a Code Jurisdiction if it meets one of two tests:

- **Listing Test:** Any of its securities are admitted to trading on a U.K.-regulated market or a U.K. multilateral trading facility or stock exchange in the Channel Islands or the Isle of Man.
- **Residency Test:** Where, although a company does not satisfy the Listing Test, the Takeover Panel (Panel) considers it to have its "place of central management and control" in a Code Jurisdiction.

When assessing the Residency Test, the Panel will look primarily at where the company's directors are resident. The Residency Test will not be satisfied if a majority of the directors are resident outside the Code Jurisdictions.

U.K. FPIs should therefore monitor and reassess their status under the Residency Test as their board composition changes from time to time.

Bid Scenarios

The frameworks within which hostile bids play out, and a target's defensive options, differ greatly for U.K. and U.S. companies.

In the U.K., if an approach is hostile, the Takeover Code's strict leak regime, its 28-day "put up or shut up" deadline for a firm bid and the "certain funds" requirement mandating unconditional financing may help to protect a target company from speculative bids and prolonged siege.

In addition, the Takeover Code's concepts of persons "acting in concert" and "interests in securities," together with its mandatory bid rules (triggered primarily at 30% ownership), can prevent parties from accumulating a controlling stake or consolidating control in a company by obliging those parties to make a cash offer for all remaining shares at the highest price paid in the preceding 12-month period. Furthermore, target companies are protected from "dawn raids" (*i.e.*, a sudden purchase of a large stake) by hostile bidders by delaying their ability to acquire controlling positions.

On the other hand, U.K.-incorporated companies are subject to legal restrictions on new share issues that reduce their defensive options compared to U.S. companies. And, if a board has reason to think a bona fide offer is imminent and the Takeover Code applies, it also restricts a board's ability to issue new shares or enter into an acquisition or disposal of assets outside of the ordinary course unless shareholder approval or the consent of the bidder is obtained.

By contrast, U.S. securities laws are generally disclosure-focused and do not provide a detailed framework for the bid process or the parties' conduct, although when a bidder acquires 5% or more of a company's shares, it must disclose that to the Securities and Exchange Commission (SEC). Other federal shareholder protections apply in the event of a tender offer.

Instead of relying on U.S. federal securities laws when faced with a hostile bid, most companies listed and incorporated in the U.S. rely on protections allowed under the laws of their state of incorporation (most commonly Delaware). These typically include the ability to implement shareholder rights plans (poison pills) and staggered boards. There is an extensive body of case law permitting these strategies.

Adoption of Takeover Code-Like Provisions

U.K. FPIs that could fall into the gray zone — without the benefits of either Takeover Code protections or the defenses available to U.S.-incorporated companies — should consider incorporating some or all of the Takeover Code's protections and restrictions through contractual or constitutional measures. This will require board and/or shareholder support and may provide only limited protection against a third-party bidder that is not already a shareholder in the company, since that bidder will not necessarily be bound by any contractual or constitutional protections.

Options include:

- **Full protection:** Including in the articles of association, or in the implementation agreement in the case of a recommended bid, a requirement that any bid be conducted as if the company were subject to the Takeover Code.
- **Partial protection:** Including in the articles of association mandatory bid rules equivalent to Rule 9 of the Takeover Code and the General Principles of the Takeover Code.
- **Limited protection:** Including mandatory bid rules in the articles of association equivalent to Rule 9 of the Takeover Code only.

Taking such measures will help ensure that the company and shareholders are protected in the event of a hostile or speculative bid. Doing so will also protect against the possibility that the company could find itself in legal limbo, with no clear set of governing rules for dealing with a bid. Ultimately, the best protection will be for the company to understand its Takeover Code status, know how it may change in certain circumstances and be prepared for all eventualities.