

# European Corporate and Financial Briefing



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## UK Takeover Panel to Require Disclosure of Derivatives Dealings

The UK Panel on Takeovers and Mergers (the "Panel") has amended its City Code on Takeovers and Mergers (the "Code") to add a requirement for disclosure of dealings in options and other derivatives to the long-standing Code requirements for disclosure of securities dealings during an 'offer period'. The new disclosure requirements will apply to dealings **from 7 November 2005** onwards.

The Code and the Rules Governing Substantial Acquisitions of Shares (the "SARs") govern takeover transactions of publicly held companies and regulate the behaviour of offerors and offerees during takeovers and proposed takeovers. The SARs apply in the period prior to a formal announcement and the Code, broadly, to the period following a public announcement of an intention to acquire 30% or more of the voting share capital of the target.

The Panel (established in 1968) is the self-regulatory body which administers the Code. Although the Panel does not have statutory powers, the Code is endorsed by the UK Financial Services Authority (the "FSA") and in certain circumstances failure to observe Code provisions can expose FSA-regulated firms to discipline. The Panel's powers extend to private reprimand, public censure and reporting a breach of the Code to the FSA or another body by which an offender is regulated.

SAR Rule 3 requires the disclosure of any acquisition of shares (or rights over shares) which takes the acquirer's aggregate holding to between 15% and 30%. For the present, the Panel has not amended this rule to add a requirement to disclose derivatives dealings.

Code Rule 8 sets out requirements with respect to dealings *during an offer period* by a person interested in 1% or more of any class of relevant securities of an offeror or of the offeree or who or as a result of any transaction will be interested in 1% or more. It should be noted that this rule is not limited to the offeror and the offeree and their associates but catches all dealings, including dealings by overseas persons such as offshore hedge funds and their discretionary managers.

The Panel began a consultation exercise in January 2005 with a view to extending the Code and the SARs to dealings in derivatives and options. It issued a second consultation document in May before announcing changes to the Code in August. For the present, no changes have been made to the SARs.

The Panel gave three reasons for requiring the disclosure of dealings in derivatives and options:

- Persons with long derivative or option positions may, through securities which are held as a hedge by their counterparties, exercise a significant degree of de facto control over the securities to which a derivative is referenced or which are subject to an option;

- Persons dealing in derivatives and options may be dealing with a view to assisting one of the parties to the offer, with the result that they should be considered to be acting in concert with the party; and
- Disclosure of dealings in derivatives and options will enable shareholders to understand better the forces at work in the market and, in particular, the reasons why the prices of offeror or offeree company securities may be moving in a particular direction.

“Derivative” has been widely defined to encompass all types of derivatives transactions (other than options which are separately defined), as follows:

“Derivative includes any financial product whose value in whole or in part is determined directly or indirectly by reference to the price of any underlying security.”

The term “dealings” has also been widely defined to include any acquisition or disposal of securities, options, derivatives or rights over any of the above instruments.

One possible change which was canvassed and rejected was a proposed requirement for a person with a significant short position but no long position to disclose his dealings in relevant securities. Although this will not be implemented at present, the Panel will keep the possibility of its introduction under review.

Code Rule 8.3 as amended will require:

- aggregation of all physical long positions, call options, long derivative positions and written put options in establishing whether a person holds 1% or more in a relevant company; and
- disclosure of dealings in any class of shares (or securities carrying rights to convert into or rights to subscribe for shares) and of dealings in long derivatives positions and in call options and written put options

relating to securities of relevant companies by a person holding 1% or more in a relevant company – or having such a holding after the dealing is completed.

Disclosure obligations will normally be triggered by reference to a person’s gross long position. However, positions can be netted against each other if each of the following conditions is met:

- the offsetting positions are in respect of the same class of relevant security;
- the offsetting positions are in respect of the same investment product;
- save for the number of securities in question, the term of the offsetting positions are the same, e.g. as to strike price and, if appropriate, exercise period; and
- the counterparty of the offsetting positions is the same in each case.

Details required to be disclosed (see Note 5 to Rule 8) include:

- the identity of the person dealing and, if different, the owner or controller of the interest;
- the number of securities to which the derivative or option is referenced;
- the close out date or exercise date;
- the reference price or exercise price

Disclosure is required to be made on forms published by the Panel and must be made by 3:30pm London time on the business day after any relevant dealing took place (Note 3 to Rule 8).

Note 8 to Rule 8 states that the Panel takes the view that where an investment decision is made by a discretionary fund manager, the manager and not the investor will be treated as having dealt in the relevant securities. This is consistent with the Panel’s view that institutions are responsible for monitoring their overall holdings in securities in order to ascertain whether any reporting thresholds have been crossed.

The Panel recognises that the implementation of these changes will require adjustments in market participants’ dealing and reporting systems. It considers

that the three month delay between the early August announcement of the new reporting requirements and their introduction in early November will provide sufficient time for implementation.

In its July Discussion Paper 05/4 on hedge funds, the FSA welcomed the Panel's changes to the Code and observed that enhanced disclosure of derivatives dealings (i.e. outside the context of an offer) would require legislative changes. The FSA suggested that the required changes to legislation could be made in the context of the implementation of the EU Transparency Directive if market participants were in favour of the changes and .has asked for comments as to whether the scope of disclosure should be broadened

Full details of the Panel's Code changes are available from the Panel's web site:

<http://www.thetakeoverpanel.org.uk/consultation/RS200502.pdf>

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