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UK Public Company Takeovers Regime: Proposed Changes to Companies in Scope – What UK Companies, Their Shareholders & Bidders Need to Know

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This update summarises the proposed scoping changes, the transitional arrangements and the implications for Excluded Companies and their shareholders and other parties considering a transaction involving an Excluded Company.

EXECUTIVE SUMMARY

On 24 April 2024, the UK Panel on Takeovers and Mergers (the primary regulator in the UK of takeovers of public companies) (the "**Panel**") published PCP 2024/1, a Consultation Paper proposing changes to the types of companies to which the City Code on Takeovers and Mergers (the "**Takeover Code**") applies.[1]

The proposed changes published by the Code Committee of the Panel (the "**Code Committee**") largely narrow the scope of application of the Takeover Code to companies registered in the UK or any of the Crown Dependencies[2] and which currently are UK-listed or listed on a stock exchange of a Crown Dependency (or were so listed at any time in the three years before the company becomes subject of a Takeover Code-regulated offer or event).

The Panel pre-consulted with a number of potentially impacted market participants and industry bodies in devising the proposed changes. It is expected that the changes will be implemented largely as set out in the consultation paper. The likely implementation date will be in Q4 2024.

If the changes are implemented as proposed, a number of companies which are currently subject to the jurisdiction of the Panel and the Takeover Code will fall outside of their jurisdiction ("**Excluded Companies**") and consequently companies and shareholders can expect to lose certain protections and benefits currently afforded to target companies under the Takeover Code. The Panel proposes to introduce a three-year transition period from the date of implementation to allow Excluded Companies to consider and implement (if so desired) alternative arrangements to address the loss of protections which will arise as a result of becoming an Excluded Company.

This update summarises the proposed scoping changes, the transitional arrangements and the implications for Excluded Companies and their shareholders and other parties considering a transaction involving an Excluded Company.

1. **Effective Financial Markets Regulation**
    a. The key principles for good financial market regulators across the international regulatory landscape would generally expect to include the following: engendering in the regulated community; being robust including having an effective enforcement mechanism in place; being proportionate and fair; ensuring all relevant stakeholders understand the regulator's approach and having a keen and active understanding of the relevant financial services markets[3].
    b. The proposed changes by the Panel is an exemplar of these principles in action and yet another instance where the Panel has demonstrate its pragmatic and agile approach to takeover regulation.
    c. The Panel is desirous of ensuring that its jurisdictional rules (being the gateway into the Code and regulation by the Panel - both of which are often seen by those unfamiliar with UK public takeover regulation as being a challenge to navigate - unusually light on black-letter law and heavy on the principles-based approach of regulation) are "clear, certain and objective".

d. Further, having undertaken a thorough pre-consultation exercise including with the key UK government ministry, financial services regulator, stock exchange and operators of secondary trading and fund-raising platforms, the Panel is mindful of not over-reaching nor imposing regulatory burdens which are not "appropriate or proportionate for pre-listing, growth phase companies"[4] nor being excessively protective in relation to certain companies post-listing.

e. Post-Brexit, the UK has been on a mission to "cement its position as a leader in science, research and innovation[5]" by supporting and encouraging growth companies and bolstering its position as a global trading centre in particular by making UK's listing regime more accessible, effective and competitive. The proposed changes of the Panel, which tighten its jurisdictional remit, are aligned with these broader policy objectives.

2. **History … Expansion & Contraction**

a. In its 56 years of operation the scope and remit of Code has seen many changes. The Code was originally drafted with quoted companies only in mind but gradually expanded to cover certain unquoted public companies (i.e. entities with or set up with a view to extending offers to large numbers of shareholders) and even certain transactions involving private companies (or those who had been recently quoted or public). The types of transactions which fall within the remit of the Code has also seen an expansion over the years to address new and novel structures that market participants have implemented to secure effective direct or indirect control of Code companies.

b. The Panel however has also been mindful to ensure that its stellar reputation and track record in relation to enforcement is upheld. In making this assessment the Panel has naturally been cognizant of its modest resources comprising a small (but effective) executive team of permanent and seconded staff. Accordingly, a cautious and risk-based approach has been adopted before extending the arm of the Panel/ Code to companies outside of its *primary remit* (being regulation of UK listed companies) to, for example, companies listed on overseas exchanges and/or whose management is outside of the comfortable (and proportionate) reach of the Panel.

c. As part of the expansionist period, in 2005[6], as a result of implementation of the EU Takeovers Directive in the UK, the Panel was required to take on "shared jurisdiction" of companies which were UK registered but not listed in the EU or were EU registered but listed in the UK. In 2013[7], the Panel changed its rules on the application of the "residency test" (see 4.c, "UK resident: What does it mean" in section 4 below) in determining whether a company was in scope and removed this additional requirement in respect of certain types of companies thus potentially expanding the numbers of companies/ transactions within its regulatory scope.

d. However, in recent years, the Code has seen a narrowing of the scope of companies within the remit of the Panel. In 2018[8], in the light of the UK's withdrawal from the EU, the Panel took the view that it was appropriate (though not a mandated outcome) to cease to have the so-called "shared jurisdiction" with relevant EU members states. At that time, it was estimated circa x40 companies ceased to be regulated by the Panel.

e. With these latest set of proposed changes, once again, there will be a number of companies which will cease to fall within scope of the Code. It is not practicable to identify the number of Code companies which will cease to be in scope as such but upon review of data between 2017 and 2024 the Code Committee estimates a reduction of the average number of transactions which it regulates from 76 to 72.

3. **Which companies will be in scope?**

a. **Primary scoping rule** - So what type of companies is the Panel proposing to regulate going forward? If the changes are implemented, the Panel would regulate companies which:

i. are registered in the UK or in any one of the Crown Dependencies (a "**Code Jurisdiction**"); AND

ii. whose securities are admitted to trading on:

a. a ***UK regulated market***[9] - for example the Main Market of the London Stock Exchange or the Aquis Stock Exchange (AQSE).

b. a ***UK multilateral trading facility***[10] - for example the AIM market operated by the London Stock Exchange and the Aquis Growth Market; or

c. a ***stock exchange*** in any one of the Crown Dependencies – for example The International Stock Exchange or "**TISE**".

We refer to companies with securities admitted to trading in any of the categories in 1. – 3. above as "**UK-listed**". As currently is the case, the Code will not apply to a company which is incorporated in or has its registered office outside the UK or one of the Crown Dependencies.

b. UK-Listed: What it does not cover - Accordingly, companies with securities trading on: (i) a matched bargain facility such as JP Jenkins or Asset Match ;(ii) a multilateral system or a platform such as the proposed new Private Intermittent Securities and Capital Exchange System (**PISCES**);(iii) a private markets (such as TISE Private Markets); or(iv) a secondary market of a crowdfunding platform such as Seedrs Secondary Market or Crowdcube,will be outside of scope.

c. Three-year secondary scoping rule - In addition, companies which are registered in a Code Jurisdiction will also be in scope of the Code if they were UK-listed at any time during the three years prior to the date of announcement of an offer or possible offer (or some other Code-relevant transaction) – the "**relevant date**". The retention of a "run-off" period is consistent with the current approach under the Code (albeit for a shorter period than the current 10 year run-off period – (see 4.b, "Private companies" in section 4 below) and is designed to address the situation where for example a company has been subject of a takeover offer, been delisted but there remains a minority which chose not to accept the offer and remain as shareholders – some level of protection is considered appropriate for this cohort.

4. **Which companies currently in scope will become out of scope?**

a. Public companies - Currently, the Code also applies to ***public companies*** registered in a Code Jurisdiction if they are "***UK resident***", regardless of whether the company's securities are UK-listed or traded on an overseas market (e.g. NASDAQ or NYSE) or traded using a matched bargain facility.

b. Private companies – Currently, the Code also applies to ***private companies*** registered in a Code jurisdiction, which are "***UK resident"*** but only if: (a) they were UK-listed at any time during the 10 years prior to the relevant date; (b) dealings in the company's securities were published on a regular basis for a continuous period of at least six months in the 10 years prior to the relevant date [NB: this would capture for example matched bargain facilities such a JP Jenkins]; (c) any of the company's securities were subject to a marketing arrangement at any time during the 10 years prior to the relevant date; or (d) the company had filed a prospectus with a relevant authority in any one Code Jurisdiction during the 10 years prior to the relevant date (together the "**10 year look-back rules**").

c. "UK resident": What does it mean? - One of the key drivers behind the proposed changes is the desire by the Code Committee to move away from a jurisdictional test which relies on "UK residency". For Code purposes, a company will be treated as being "UK resident" if the place of central management and control of a company is in one the Code Jurisdictions. Of note, this is not a tax or other regulatory residency test. The Panel has applied its own test of "central management and control" which it has developed and indeed simplified over time. In the first instance, residency is tested against a quantitative test of where the majority of the board of a company reside but the Panel reserves the discretion to assess more qualitative factors (e.g. giving consideration to the specific roles of the members of the board) depending on the facts and the outcome of the quantitative test. By its nature, the "residency" of a company for Code purposes can change over time depending on where the majority of the board reside and indeed many companies have deliberately ensured that the majority of their board are not "UK resident" in order to avoid falling within the scope of the Code and regulation of the Panel. One of the challenges of the UK residency test (in addition to its more subjective and potentially shifting nature) is that it is "often not possible to ascertain from publicly available information whether at any point in time an unlisted public company [i.e. a non-UK Listed company] or a private company satisfies the residency test"[11]. For example, a UK registered which is listed on an overseas exchange may not be required to disclose and/or update its "UK residency" and relate Code status under applicable exchange and securities law or regulatory requirements. The Panel is no longer comfortable with this position and is desirous of putting in place a regime which allows both companies and market participants to reach an objective determination as to whether a company is or is not a Code company.

d. UK residency test removed - Accordingly, the proposed changes involve the removal of the "UK residency" test scoping limb and also materially modify the 10-year look back rule replacing the latter simply with a three year look-back rule for UK-listed companies only.

e. **Excluded Companies** - As a result of these changes, the following companies (each being an Excluded Company) will no longer be subject to the jurisdiction of the Code:

i. a public or private company which was UK-listed more than three years prior to the relevant date;

ii. a public or private company whose securities are, or were previously, traded solely on an overseas market;

iii. a public or private company whose securities are, or were previously, traded using a matched bargain facility such as JP Jenkins or Asset Match;

iv. any other "unlisted" public company; and

v. a private company which filed a prospectus at any time during the 10 years prior to the relevant date,

unless the company had been UK-listed at any time during the three years prior to the relevant date.

5. **Transitional arrangements for companies currently in scope which will become Excluded Companies**

a. The Code Committee considers that it is appropriate that Excluded Companies – being companies currently within (or potentially within the scope of the Code - to be given a period of time to adjust to the new regime. These will cover public companies referred to in paragraph ?a above and private companies described in paragraph ?4.b above.

b. These companies which will be referred to as "**transition companies**" will remain within the scope of the Code for three years from the date of implementation of the new scoping rules.

c. The Code Committee has summarised out in its consultation paper the proposed transitional arrangements (see Appendix C) and has also provided helpful infographics to identify if a company is a "transition company" on the implementation date (see Appendix D) and if it will be a transition company in respect of a specific transaction (see Appendix E).

d. The Panel expects transition companies to use this period to consider whether it is appropriate to implement alternative arrangements in the light of their pending exclusion from the Code. As noted above, the Code provides a number of protections for companies which find themselves in receipt of a potential takeover offer (target companies) and their shareholders. These include but are not limited to enhanced disclosure of interests and dealings when a company is in play, rules requiring equivalent treatment of all shareholders, the requirement for a person and their "concert parties" who obtains or consolidates control to make a "mandatory offer" on similar terms.

e. Alternative arrangements (which will likely come with cost) may include a transition company:

i. seeking admission of its securities to trading on a relevant UK market (e.g. a secondary listing) in order to become subject to the jurisdiction of the Panel;

ii. seeking admission of its securities to trading on another market in order to become subject to regulation of a comparable securities regulator;

iii. amending its Articles of Association to incorporate new provisions which are similar to or based upon certain 'key' provisions and protections of the Code; and/or

iv. implementing arrangements to facilitate an orderly exit of shareholders who do not wish to remain holders in a company without the protections granted by the Code.

f. If the transition company proposed to entrench new "Code-like" provisions into the contract with its members (i.e. its Articles of Association), it will be for the company to assess (ideally taking into account the views of investors and other relevant stakeholders) which Code provisions they consider appropriate to incorporate. Amended governance documents will however need to be approved by shareholders. Shareholders will need to understand that whilst their new articles of association may include certain Code-like or Code-inspired provisions, the Panel will not have jurisdiction to regulate enforcement of these provisions.

g. Excluded Companies (and companies who have previously publicly disclosed the potential application of the Code depending on whether they satisfy the UK resident test) including those traded on overseas exchanges, will need to consider whether and when to disclose to shareholders that they will no longer become subject to (or potentially subject to) the jurisdiction of the Code and Panel and the protections to shareholders that this affords. This will be dictated in part by reference to the (overseas) exchange and securities regulation applicable to such companies and the nature of any prior disclosures made to shareholders/ the public.

6. **Implications**

a. For Excluded Companies
Directors of these UK registered entities have a duty to promote the success of the company for the benefit of its shareholders taking into account, among other things, the interests of its employees. Companies which will become an Excluded Company should start to give early consideration about what alternative options the company should consider implementing if any in the light of the loss of protections both for the company (in the event it becomes subject of an offer), its shareholders and (to a lesser degree, its employees) when it becomes an Excluded Company. At the least, it should start to prepare to engage with its shareholder based on these issues

b. For Shareholders of Excluded Companies
Shareholders of companies who will fall outside of scope, as part of their stewardship duties and taking account (where relevant e.g. in the case of institutional investors or sovereigns) their fiduciary duties to their ultimate beneficiaries, they should start to give consideration to what are the key shareholder protections/regulatory expectations they have as a result of their investee company being a Code regulated company and what protections if any they consider critical to preserve going forward. Armed with this analysis and assessment they can then prepare to pro-actively engage at an early stage with investee companies which will fall to become an Excluded Company and/or to actively participate in any outreach and engagement that these companies may have with shareholders going forward during their transition periods. Is the “mandatory offer” concept a key protection from “effective”/ 30%+ controllers? How much comfort is taken from the “rule against frustrating action”?

c. For Parties Interested in an Excluded Company
Parties engaging with Code companies, whether with a view to carrying out a takeover offer, other Code regulated transaction or indeed even seeking to transact with a Code company which is “in play” (a “**Code Transaction**”), can find compliance with the Code’s target-company/target-shareholder friendly regime somewhat costly and burdensome in particular, if this is in addition to compliance with overseas exchange and securities law requirements which apply to that company in parallel. The prospect of undertaking a transaction outside of the regime of the Code may indeed be welcome. Whilst we are some years away from the end of the transitional period for Excluded Companies and these companies falling out of scope of the Code, third parties who may be considering a Code Transaction closer to that end date, should be mindful of that date and/or of any alternative arrangements that the Excluded Company may implement when assessing timing (e.g. waiting till post the expiry of the transitional period) and the structure of any possible transaction.

7. **Next Steps & Timing**

a. Comments to the Consultation Paper should be sent to the Code Committee in writing or by email[12] by 31 July 2024.

b. The Code Committee intends to publish a response statement to the consultation in Autumn 2024 and the expected implementation date of the changes is circa one month after publication of this response document.

c. As noted above, the transition period for Excluded Companies to prepare for exclusion is three years from the implementation date.

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[1] PCP 2024/1 – Companies to which the Takeover Code applies

[2] These are the Isle of Man, Guernsey and Jersey

[3] ICAEW Principles For Good Financial Regulators

[4] Paragraph 2.20 of PCP 2024/1

[5] UK Government Innovation Strategy Statement Nov 2023

[6] See PCP2005/5 – The implementation of the Takeovers Directive.

[7] See PCP2012/3 – Companies subject to the Takeover Code

[8] See PCP 2018/2 – The United Kingdom's withdrawal from the European Union

[9] As defined in paragraph 13(a) of Article 2(1) of Regulation (EU) No 600/2014 on markets in financial instruments ("**UK MiFIR**")

[10] As defined in paragraph (14A) of Article 2(1) of UK MiFIR

[11] Paragraph 2.14 of PCP 2024/1

[12] Email to supportgroup@thetakeoverpanel.org.uk

The following Gibson Dunn lawyer prepared this update: Selina Sagayam.

If you have any questions on the impact of the proposed changes, including application of the transitional arrangements, or are seeking advice on assessing and implementing alternative arrangements for companies which will come out of scope of the Code, we are happy to assist.

For questions about this alert or other UK public M&A or capital market queries, contact the Gibson Dunn lawyer with whom you usually work, the author of this alert or these public listed company and capital markets contacts in London:

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